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# Assessment of Reputational Risk Management Maturity Levels of Banks

*Bankaların İtibar Riski Yönetimi Olgunluk Seviyelerinin Değerlendirilmesi*

**Turgay GEÇER**
*Doç. Dr., Fatih Sultan Mehmet Vakıf Üniversitesi,*
*İİBF, İşletme Bölümü, tgecer@fsm.edu.tr*
https://orcid.org/0000-0003-4430-2273

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**Kaan Ramazan ÇAKALI**
*Dr., Türkiye Kalkınma ve Yatırım Bankası,*
*kaanramazanc@gmail.com*
https://orcid.org/0000-0003-4186-2291

**Gürol BALOĞLU**
*Dr., Süzer Grubu, gurol@live.com*
https://orcid.org/0000-0003-1093-2664

**ÖZET**

*Faaliyetlerinin doğası gereği itibar riski bankalar açısından yönetilmesi gereken temel risklerin başında gelmektedir. Kurumsal itibarın maddi olmayan bir varlık olması sebebiyle itibar riskinin ölçümü son derece zordur. Buna karşın bankaların itibar riskinin yönetimine yönelik olgunluk seviyeleri maruz kalınabilecek itibari kayıpların etkilerinin azaltılması yönünden son derece önemlidir. Bu çalışmanın amacı, bankalarda itibar riski yönetimi olgunluk seviyesinin değerlendirilmesine yönelik bir çerçeve geliştirmektir. Bu amaçla COSO Kurumsal Risk Yönetimi Çerçevesi baz alınarak itibar riski olgunluk seviyesinin değerlendirilmesinde kullanılabilecek nitelikler, bu niteliklere ilişkin değerler ve her bir niteliğe yönelik değerlendirme kriterleri tanımlanmıştır. Ayrıca, Bak and Jedynak (2023) dikkate alınarak her bir nitelik için hesaplanan değerlerin birleştirilmesiyle elde edilen toplam puana göre bankalar için 5 farklı olgunluk seviyesi oluşturulmuştur. Önerilen bu çerçeve, itibar riski yönetiminin olgunluk seviyesinin belirlenmesi açısından bankaların kendilerini ve yasal otoritelerin bankaları değerlendirebilecekleri bir çerçeve olarak kullanılabilir.*

***Anahtar Kelimeler:***

*Risk Yönetimi,*

*İtibar Riski Yönetimi,*

*İtibar Riski Olgunluk Seviyesi,*

**ABSTRACT**

*Due to the nature of their activities, reputational risk is one of the main risks that should be managed for banks. Since corporate reputation is an intangible asset, it is extremely difficult to measure reputational risk. On the other hand, the maturity level of banks for the management of reputational risk is extremely important in terms of reducing the effects of reputational losses that may be exposed. The aim of this study is to develop a framework for evaluating the maturity level of reputational risk management in banks. For this purpose, based on the COSO Enterprise Risk Management Framework, the attributes that can be used in the evaluation of the reputational risk maturity level, the values related to these qualifications and the evaluation criteria for each attribute are defined. In addition, 5 different maturity levels were created for banks according to the total score obtained by combining the values calculated for each attribute, taking into account Bak and Jedynak (2023). This proposed framework can be used as a framework in which banks can evaluate themselves and legal authorities can evaluate banks in terms of determining the maturity level of reputational risk management.*

***Keywords:***

*Risk Management,*

*Reputational Risk Management,*

*Reputational Risk Maturity Level,*

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## 1. INTRODUCTION

Banks face a wide variety of financial and non-financial risks such as credit, operational, reputational, liquidity, interest rate, etc. Risk arising in any category may affect other risk types as well as adversely affect the activities of the bank. For this reason, it is extremely important for banks to define, assess, measure and monitor these risks and take them under control with the actions taken.

One of the prominent reasons of the financial crises experienced is the damage to the corporate reputation as a result of the loss of trust of the customers. A bank's positive reputation will ensure that stakeholders have a positive perspective and confidence in the banking sector. For this reason, reputational risk emerges as an increasingly important type of risk compared to the different types of risks faced by banks (Laurens, 2012:1).

Reputational risk has emerged as a type of risk that has increased rapidly in terms of impact and probability for banks in recent years, especially due to technological developments, the increase in the expectations of legal authorities from banks, globalization, the diversification of products and services offered by banks, and the widespread use of social media. It can be defined as the possibility that the bank's reputation will be damaged as a result of its activities. According to a global survey conducted by Deloitte (2015), 87% of the executives consider reputational risk a much more important risk than other strategic risks of companies.

The purpose of this study is to propose a framework for assessing the maturity levels of banks' reputational risk management. The objective of the framework proposed in this study, unlike other studies in the literature that make suggestions for measuring reputational risk, is to provide a proposal for assessing the maturity level of banks' reputational risk management. In other words, it is to present a proposal for evaluating the extent to which they integrate the reputational risk management processes on paper into their corporate risk management processes.

Within the scope of the study, attributes for reputational risk management, criteria for each attribute and values for grading of these attributes are defined. In addition, score ranges for the calculation of banks' reputational risk management maturity levels were determined and defined. As a result, a framework has been developed by which banks can make their own self-assessments or legal authorities can evaluate banks in terms of reputational risk management maturity.

This article is divided into seven sections. The first section provides the summaries of the studies in the literature on banks' reputational risk. The following sections provide a conceptual framework of reputation, reputational risk, and reputational risk management in banks. The next section proposes a framework for assessing the maturity level of banks' reputational risk management. The final section presents the findings and recommendations of the study.

Although reputational risks do not occur in daily activities in today's banking, they are a type of risk that can have devastating consequences if they occur. Since the banking system is based on trust, but with the emergence of many factors that threaten this trust with developing communication technologies, reputation risk has become an issue that needs to be handled carefully. This study aims to present a different approach to handling this risk, which is of vital importance for banks.

The contribution of this study to the literature can be listed as focusing on the maturity level of reputational risk management in banks, determining the criteria for its evaluation and proposing an application framework. The approach put forward by our study offers a situation analysis solution for reputation risks and once again emphasizes the importance of reputation risks in the banking sector.

## 2. LITERATURE REVIEW

Summary information on academic studies that stand out in the national and international literature on reputational risk in banks is explained in this section.

Savram and Karakoç (2012) analyzed the importance of reputational risk for banks in conceptual framework. In the study, reputational risk is evaluated specifically for the banking sector, and actions that can be taken to protect the reputation of banks and reduce reputational risk are included. The main measures that can be taken for the management of reputational risk in banks are listed as timely communication with stakeholders, compliance with regulations and creation of crisis management team, establishment of corporate risk management processes, risk culture, and ethical codes of conduct.

Sturm (2013) made research on reputational risk and operational risks in the European banking sector. In the study, based on 136 loss events, the reaction of the stock market to the operational losses of banks in the period of January 2000 - December 2009 is analyzed. The results reveal that the announcements regarding the operational loss amounts affect the stock prices negatively and that the nominal losses are affected by the company characteristics rather than the operational loss events.

A study on the determinants of reputational risk in banks was conducted by Fiordelisi et al. (2013). An empirical application for banks operating in Europe and the USA during the 2003-2008 period is included in the study. The results show that the increase in the asset size and profitability of the banks causes the possibility of reputational damage to increase. In addition, it is concluded that there is a negative relationship between the amount of invested capital and intangible assets and the possibility of reputational damage.

Walter (2014) analyzed the changing effects of reputational risk in the banking and financial sector after the financial crisis in conceptual framework. In this study, the unique structure of the banking and finance sector is explained and the importance of reputational risk is emphasized in this structure. In addition, the role of personal responsibility and cultural factors in effective corporate governance processes is mentioned and how these factors should be taken into account for the effective management of reputational risk is explained.

Xiang and Lina (2014) investigated the reputational risk management processes of banks operating in China. In the study, it is stated that the reputational risk management processes of the banks in question are not at the expected level, the awareness level of the employees is insufficient, the legal authorities do not take adequate actions regarding the monitoring processes of the banks, and the media affects the perceptions of the banks. In addition, suggestions are made for banks to improve their reputational risk management processes, to create a reputational risk culture to establish monitoring mechanisms by legal authorities and to review the communication of banks with the media.

Empirical research was conducted by Miklaszewska and Kil (2016) to measure the importance and impact of reputational risk in banks. In this study, the application of stakeholder reputation score calculation for 42 banks in CEE stock exchange is included. The results show that reputational risk management is not that important in terms of evaluating financial performance, and that crisis management processes are more essential following the emergence of reputational risk-based crises.

Gündoğdu (2016) examined reputational risk and its management in the Turkish banking sector. Within the scope of the study, national regulations for the prevention and management of reputational risk in banks are explained and sample cases in the banking system are included.

In the study conducted by Eckert and Gatzert (2017) operational risk models for banks were extended to include reputational risks. In the study, three different models are proposed in order for banks to cope with the losses caused by reputational risk. The results reveal that the losses due to reputational risk can be much higher than losses due to operational risk, and if they are ignored, some types of operational risks will be underestimated.

Buriak and Artemenko (2018) conducted a study on the reputational risks that banks are exposed to in Ukraine. In the study, approaches and assessments of reputational risk in banks and the determinants of reputational risk in the Ukrainian banking sector are given. In addition, an application proposal has been made for the assessment of reputational risk in banks.

Zaby and Pohl (2019) studied the management of reputational risks in banks. In addition, they proposed a model for the evaluation of banks' reputations. The scope of the study consists of banks operating in Germany and Switzerland. It is concluded that the level of reputation depends on the changes in the reputation factors and stakeholder expectations. In addition, effective management of reputational risk in banks will prevent negative spillover effects from banks.

A study was conducted by Trostianska and Semencha (2020) on the factors affecting reputational risk in banks. In the study, an application proposal for the strategies, modelling methods and scenario analyzes to be used in determining and managing the reputational risk level in banks is given.

The effect of reputational risk on firm value in the banking sector was discussed by Sakarya and Çalış (2020). The sample set of the study consists of operational losses in banks that are publicly traded between 2007 and 2017. Whether these losses cause reputational risks or not is the subject of the study. The results obtained reveal that negative abnormal returns occur on the day of the announcement of operational losses. It is also determined that the effects of loss announcements disappear in the following time period.

Tachiciu et al. (2020) conducted a study on reputational risk in the Romanian banking sector. The main purpose of the study is to investigate how banks handle the reputational risk and to subject their non-financial reporting to content analysis in terms of sustainability. The results show that there are delays in understanding the importance of reputational risk in the Romanian banking sector.

Kedarya et al. (2021) examined entrepreneurial reputational risk in banks. In the study, a methodology is proposed for calculating the reputational risk of banks in terms of risk assets. In addition, an application proposal is developed for the use of the calculated metric in the process of calculating the capital adequacy ratio of banks.

## 3. CORPORATE REPUTATION

Corporate reputation can be defined as the capital obtained as a result of the conscious presentation of the operating results of the enterprises and the transparent presentation of the business capabilities (Fombrun et al., 2000:87). The strength of corporate reputation is the result of the relations between the business and its stakeholders and the level of trust of the stakeholders in the business (Gümüş and Öksüz, 2010:112).

Corporate reputation is a moral value that shows how businesses are perceived by third parties. It has a structure that is unstable, difficult to control and can easily become negative. Reputation is earned as a result of business activities. The level of corporate reputation is determined as a result of its positive and negative activities, behaviours and attitudes in the market. In order for businesses to have a high reputation in the market in which they operate, they must first be aware of which actions are perceived as good and which actions are perceived as bad (Honey, 2009:1-11).

Corporate reputation is one of the main indicators of the prestige of businesses (Eccles and Newquist et al., 2007:109). It is shaped over time, is closely linked to the operating period of the business, and has the potential to move businesses to a more competitive and more protected structure against their competitors (Scott and Walsham, 2005:311). It has a complex structure. For this reason, it is extremely difficult to define, evaluate and measure (Larkin, 2003:45).

Corporate reputation of a business is mainly determined by its relationships with stakeholders. Stakeholders make an assessment based on the past behaviour of the company and have a certain perception about its reputation. The factors that direct corporate reputation can be listed as follows (Rayner, 2003:15);

- Businesses with stable financial performance are more reputable and attract more investor attention.
- Companies with effective corporate governance mechanisms are more likely to protect their reputations.
- Companies that attach utmost importance to and comply with legal regulations build trust with their shareholders and stakeholders, and their corporate reputation is positively affected.
- In order to have a good corporate reputation, it is important for businesses to meet the expectations of their customers.
- The reputation of companies that create a working environment that will ensure employee satisfaction will be positively affected.
- Companies that act in accordance with corporate social responsibility principles will have a better reputation.
- Businesses that establish communication and crisis management processes will be able to protect their reputations more easily than others.

Institutions with a high reputation have the opportunity to set better prices, are attractive to investors, are more resistant to crises, are forgiven more easily by their stakeholders when they make mistakes, and can employ qualified human resources (Balkan, 2018:24).

## 4. REPUTATIONAL RISK

Basel Committee on Banking Supervision (BCBS) explains reputational risk as arising from non-compliance with legal regulations, operational errors and other sources. Due to the nature of banking activities, it is important to ensure the trust of depositors, markets and creditors. For this reason, reputational risk can cause significant negative effects for banks (BCBS 1997:23). This definition considers reputational risk as harmful, following the manifestation of compliance and operational risks and sources not fully determined.

Reputational risk can also be defined as the losses that may be incurred as a result of damage to the trust in the business and corporate reputation due to operational failure or non-compliance with legal regulations (Savram-Karakoç, 2012:329). The concept of reputational risk refers to potential threats and losses (Kızılboğa Özaslan and Özşahin Koç, 2016:277). Operational losses that businesses are exposed to include some failures and although they cause very low financial losses, they attract the attention of stakeholders. For this reason, they may cause a damaging effect on corporate reputation (Sturm, 2013:192). Reputational losses due to operational losses in businesses are also called as indirect operational losses (Chernobai et al., 2007:30).

Honey (2009) attributes reputational risk to three reasons as cultural, managerial and external. Cultural reasons include the reasons that arise as a result of ethical rules and legal regulations. Administrative reasons include the administrative reasons that arise in the decision-making processes of the senior management and the reasons that arise as a result of the transactions arising from the activities of the middle managers. Extrinsic causes are those caused by external factors.

Basically, five stages can be mentioned regarding the management of reputational risk. These stages are as follows (Eccles et al., 2007);

- Carrying out studies on the reputation of the enterprise,
- Evaluation of the real situation of the business,
- Determining the difference between the real situation of the business and the perceptions of the stakeholders and trying to close the existing gap,
- Monitoring the changes in perceptions,
- Assigning personal responsibility for managing reputational risk.

### 4.1. Reputational Risk in Banks

Banks serve a large number of customers, both individual and corporate. They offer a wide range of products and services such as loans, deposits, credit cards, insurance, internet banking, etc. to their customers through head office units and/or branches. Considering the product variety, product and customer volumes, banks are expected to face very different types of risks such as credit, operational, liquidity, market, reputational, etc. (Crouhy et al., 2014:24).

Reputational risk is classified as one of the main types of risk faced by banks. Globalization, the widespread use of social media, increasing legal regulations, the recognition that reputation is an intangible asset, the differing expectations of shareholders and stakeholders, and the understanding of the benefits of good reputation are the factors that have increased the importance of reputational risk management in both financial and non-financial sectors in recent years (Mukherjee et al., 2015:5).

Reputational risk in banks can be defined as the possibility of loss that may arise as a result of negative perceptions of current or potential customers, regulatory authorities, competitor banks and shareholders towards the bank, loss of confidence in the bank or damage to the bank's reputation. The ability of banks to maintain existing relations, establish new relations or access various financing resources may be adversely affected due to negative thoughts and perceptions that may occur in the presence of shareholders or stakeholders (BCBS, 2009:19). Reputational risk is a type of risk that is inherently involved in all activities of banks.

According to BCBS (2001), reputational risk is the possibility that the negative effects of a bank's practices and partnerships may damage the trust in the bank (BCBS 2001:4). Reputational risk is the actions that create a negative impact on the activities of the bank and significantly damage the relations of the banks with their stakeholders. Reputational risk may arise due to bank's own activities or in response to the actions of third parties. Increasing reputational risk in banks will adversely affect other risk categories, especially operational risk (Takan, 2002:400-401).

Reputational risk arises from different operational risks. For example, risks arising from technology may cause loss of confidence and reputational losses for banks. As a result of losses arising from operational risk, banks should also take into account additional costs arising from reputational risk. (Sweeting, 2011:109-110). Banking is based on the trust relationship between banks and their customers. Due to this unique structure of banking, it is more likely to be exposed to reputational risks (Crouhy et al., 2014:41).

Sources of reputational risk should be determined by banks, and processes and controls for their management should be established. The possible sources of reputational risk that banks may be exposed to are listed by BRSA as financial performance, customer satisfaction, compliance with applicable legal regulations, rumours, shareholding structure, risk management, corporate governance, accountability, transparency, personnel competence, etc. (BRSA, 2016:2-3).

### 4.2. Reputational Risk Management in Banks

For the effective management of reputational risk, management should define and document all the risks that the business is exposed to. These risks should be well understood and evaluated periodically. After these evaluations, remedial actions should be planned and a proactive approach to risks should be provided (Rayner, 2003:94). There are several factors that affect corporate reputation. It is important for management to determine the factors that will cause loss of reputation and to plan and implement corrective actions.

Reputational risk management is an important component of banks' risk management processes. Strong risk management system to be established by banks will ensure the management of reputational risks, as in other risk types. Reputational risk in banks refers to the negative evaluations of internal and external stakeholders about the company. As a result of the reputational risk, banks may face loss of customers, financial losses and panic withdrawals by depositors, and a crisis environment may arise not only for the bank but also for the financial system. For this reason, reputational risk should be managed as a component of banks' risk management processes (Xiang and Lina, 2014:1795-1796).

The process for managing reputational risk in banks consists of the stages of defining, assessing, controlling, monitoring, reporting, communicating and publicizing risks. The main responsibility of the senior management and the board is to establish processes related to the management of reputational risk, to ensure their functionality and to establish and approve internal regulations (BRSA, 2016:4). The processes to be applied for the management of reputational risk in banks can be listed as the following (BRSA, 2016);

- <u>Establishment of Internal Policies and Procedures</u>

Internal policies and procedures regarding the effective management of reputational risk should be established by senior management. All stages of reputational risk management should be included in these regulations. Acceptable risk limits should be defined and announced to all parties.

- <u>Identifying, Assessing and Controlling Risks</u>

Banks should establish structured processes for the identification, assessment and control of reputational risks, taking into account their business plans, needs and risk profiles. During the identification of reputational risks, risks should be clearly identified and included in the bank's risk management framework. Internal and external sources of reputational risks should be determined. In addition, the risks that may arise with new fields of activity or projects should also be taken into account.

During the assessment of reputational risks, probability analyzes should be performed and written documents should be created to evaluate reputational risks and prioritize them according to their importance levels. Tools such as control self-assessments, stakeholder impact assessments and stress tests can be used to measure the likelihood of risks occurring.

Following the identification and evaluation of risks, action plans should be created to control them. The action plans created should also be reviewed periodically.

- Monitoring and Reporting

Banks create action plans for the management of reputational risk and periodically review and report their implementation levels. In addition, they establish early warning systems regarding reputational risk such as interruptions in banking services, increase in customer complaints, increase in lawsuits, and news about the bank in the press.

- Communication and Disclosure

Banks' relations with their stakeholders should be transparent, clear, consistent and timely to meet the expectations of the stakeholders. Communication with stakeholders can be derived through channels such as the website, annual reports, press releases, etc.

## 5. REPUTATIONAL RISK MANAGEMENT MATURITY ASSESSMENT FRAMEWORK

In this section, a framework will be developed in order to evaluate the reputational risk management maturity levels of banks. Within the scope of our study, the "*Risk Management Maturity Assessment Model*" recommended by Bak and Jedynak (2023) was taken as an example and this model was redesigned specifically for reputational risk in order to evaluate the maturity levels of reputational risk management for banks. Also, the components and principles of COSO Enterprise Risk Management (ERM) framework are also taken into consideration in our proposal.

### 5.1. Risk Management Maturity Assessment Model of Bak and Jedynak (2023)

Bak and Jedynak (2023) defined 8 attributes primarily for evaluation while creating the model they propose for evaluating the risk management maturity level of companies. These attributes are classified as strategy, processes, culture, standards and procedures, planning and goals, crisis resilience, roles and responsibilities and compliance. In the second step, value scales are defined for each attribute determined and a morphological matrix is obtained. Each attribute is assessed on a five-point scale ranging from 1 to 5. Values in the matrix indicate the degree of professionalism of the institution for each attribute evaluated. At the next stage, aggregate scoring is made to evaluate the risk management maturity level. Five maturity levels are defined as fragmentary, basic, completed, professional and superb, explanations of each maturity level are made and score ranges are determined (Bak and Jedynak, 2023:50-53).

### 5.2. COSO ERM Framework

COSO ERM Framework is the product of the Committee of Sponsoring Organizations of the Treadway Commission. The first version of the framework was published in 2004. In 2017, the framework was revised, and its second version was published with the name of "*Integrating with Strategy and Performance*", emphasizing the importance of risk concept during strategy setting and operations.

The framework defines ERM as the combination of set of risk management activities in (i) recognizing culture, (ii) developing capabilities, (iii) applying practices, (iv) integrating with strategy-setting and performance, (v) managing risk to strategy and business objectives and (vi) linking value (COSO, 2017:8). The framework claims that integrating ERM with business enables the decisions aligned with risks and opportunities (COSO, 2017:14). COSO's ERM Framework consists of five components including twenty principles attached to these components. These are presented in Table 1 below.

**Table 1.** COSO Enterprise Risk Management Framework Components and Principles

| Component | Principle |
|---|---|
| Governance and Culture | Exercises Board Risk Oversight |
| | Establishes Operating Structures |
| | Defines Desired Culture |
| | Demonstrates Commitment to Core Values |
| | Attracts, Develops, and Retains Capable Individuals |
| Strategy and Objective Setting | Analyzes Business Context |
| | Defines Risk Appetite |
| | Evaluates Alternative Strategies |
| | Formulates Business Objectives |
| Performance | Identifies Risk |
| | Assesses Severity of Risk |
| | Prioritizes Risks |
| | Implements Risk Responses |
| | Develops Portfolio View |
| Review and Revision | Assesses Substantial Change |
| | Reviews Risk and Performance |
| | Pursues Improvement in ERM |
| Information, Communication and Reporting | Leverages Information and Technology |
| | Communicates Risk Information |
| | Reports on Risk, Culture, and Performance |

Source: COSO, 2017:17.

### 5.3. Reputational risk Management Maturity Assessment Framework Proposal

In our study, considering COSO's ERM Framework and Bak and Jeynak (2023)'s Risk Management Maturity Assessment Model, a reputational risk management maturity assessment framework is proposed. To do this, attributes and their criteria are determined to identify the maturity level of reputational risk management in banks, and then a scale for reputational risk management maturity level assessment is proposed. The specified attributes, derived from risk management principles of the COSO model and revised with reputational risk perspective, are explained below.

*1. Governance and Culture:*

A governance structure should be designed within the organization that includes roles and responsibilities related to the management of reputational risk. Issues related to reputational risk should be handled within the framework of the board and related committees. Actions should be documented and approved. Behaviours and actions towards reputational risk should be determined by the board in line with the objectives of the business. Board and relevant committee members should have expertise and experience in reputational risk. A risk committee or a separate committee for the management of reputational risk should be established within the board. This committee should define and monitor the reputational risk governance framework and trigger action on detections. There should be representatives from the risk management unit and other units operating independently in the committee, and issues that require quick action should be intervened in a timely manner. The committee should have a written charter, its duties and responsibilities should be defined, its membership structure should be determined and its meetings should be recorded. Materiality levels for risk events should be identified and events above these levels should be reported to the board and the committee responsible for reputational risk. Risk and control functions should be positioned as part of the board's strategy development processes.

Awareness should be raised among employees regarding the effective management of reputational risk within the bank and a risk culture should be established. Reputational risk behaviours that support the reputational risk management framework of banks should be determined and documented. Senior management should share the bank's reputational risk strategy and reputational risk management framework with employees. Reputational risk behaviours and the corporate culture and values of the bank should be linked to each other. Each bank employee should be aware of their responsibilities in the reputational risk management process. It should be ensured that the purpose and scope of the bank's reputational risk framework are understood by the employees through internal policies and procedures. Expected behaviours in reputational issues from employees should be defined and actions can be taken against the violations of these behaviours should be defined. Respected committees such as the disciplinary committee should be nominated in decisions against violent behaviours.

On the other hand, The Three Lines Model of IIA (Institute of Internal Auditors) positions internal audit on the third line as an independent assurance and consulting function (IIA, 2020:3). For this reason, the third line roles and responsibilities in the reputational risk management process are fulfilled by the independent internal audit units within the banks. Independent assurance and consultancy services should be provided by internal audit units regarding the reputational risk management strategy, framework and practices of banks.

Reputational risk management strategy and framework should be reviewed periodically, documented roles and responsibilities should be reviewed, and each component related to reputational risk should be taken into account in risk assessment studies conducted within the scope of the annual internal audit plan. Within the scope of the annual internal audit plan, the processes related to the management of reputational risk and the effectiveness and adequacy of the controls in the processes should be reviewed. In addition to assurance services, activities such as providing opinions, training and consultancy on reputational risk management processes should be carried out by the internal audit units within the framework of the bank's needs.

Personnel of sufficient quality and quantity should be employed within the independent risk management unit to manage reputational risk in the bank. Roles and responsibilities of these employees should be defined, and they should be provided with the necessary competencies to ensure that they can fulfil the effective oversight function regarding the management of reputational risk and manage reputational risk within the first line. In the second line for the management of reputational risk, performance criteria specific to the risk management function should be defined and monitored. The sources of the bank's reputational risk should also be evaluated by the internal audit unit located on the third line. In the management of reputational risk, it should be ensured that other necessary resources such as technological tools are allocated in addition to human resources.

*2. Strategy and Objective Setting:*

Regarding the effective management of reputational risk, there should be a reputational risk management strategy in line with the strategic objectives of banks and the ERM framework. This strategy should include first, second, and third-line roles, reviewed periodically, revised or updated as necessary, and approved by the board. The strategy should include processes, roles and responsibilities on how to manage reputational risk and identify, evaluate, monitor and report reputational risks.

COSO (2017) defines risk appetite as the level of risk that companies are prepared to accept. The banks should establish a reputational risk appetite framework. In order for a bank to continue its activities in line with the targets it has set, it is necessary to determine the levels and types of reputational risk that it can take. In this context, limits can be determined, numerical or non-numerical criteria and metrics for reputational risk can be used. First, second- and third-line roles are defined for reputational risk appetite. It is periodically reviewed, subject to necessary changes and approved by the board. It should be linked to and support the bank's reputational risk management strategy. Metrics created for monitoring reputational risk should be associated with reputational risk appetite metrics. While determining the reputational risk appetite, all stakeholder groups of the bank, such as customers, legal authorities, etc. should be taken into account. In analyzing business context, defining risk appetite, evaluating alternative strategies and formulating business objectives, reputational risks should also be considered as other general risk types.

*3. Performance:*

Since in COSO framework, performance component generally covers traditional risk management process, risk identification, risk assessment and risk responses represent main steps of the risk management for this attribute.

There should be a reputational risk identification framework documented and implemented within the bank. It must be approved by the relevant management levels and must be applied continuously. This framework should be reviewed periodically, important risks should be identified, and risks that may arise from a forward-looking perspective should be determined. Processes for identifying reputational risks, and first, second- and third-line roles should be defined. The sources of reputational risk should be determined and the process of collecting information about these sources should be operated. The process of identifying reputational risk should be part of the ERM process of the bank and should be integrated with other components of reputational risk management. Risk definitions should be made for each business line on process and product basis. Risk definitions should be made not only for existing risks, but also for potential risks.

Documented risks and existing controls for these risks enable senior management to become aware of significant reputational risks and to evaluate the effectiveness and adequacy of controls. Reputational risks should be considered as a component of risk control self-assessment (RCSA) studies that are carried out periodically within the bank. Different methods other than RCSA can be applied to assess these risks. Once reputational risks have been identified, degrees of inherent risk must be determined, controls defined, and controls matched with inherent risks. The effectiveness of the internal control environment should then be evaluated. Residual risks should be calculated and action plans should be determined as a result of all calculations and their implementation levels should be monitored. Grading scales should be established to assess inherent and residual risks. In addition to financial risks that affect reputation, non-financial risks should also be taken into account during assessment studies. These assessment processes should be periodically reviewed within the framework of changes in the risk management strategy or risk appetite of the bank.

Bank-wide trainings should be organized to increase employee awareness of reputational risk management and the bank's reputational risk management framework. Current employees and the newcomers should be taken into account within the framework of training programs, special trainings should be organized according to unit, function or title levels if necessary, and training programs should be supported by the bank's board and risk management committees. First, second, and third-line roles and responsibilities for reputational risk training should be defined. Trainings for reputational risk management may include the bank's reputational risk management strategy, components of the reputational risk management framework, reputational risk appetite, example loss events due to reputational risk and corrective action plans, and employees' responsibilities in the management of reputational risk. Reputational risk training should be reviewed periodically, employee participation in trainings should be monitored, and reports should be made to the board and risk committee about training activities. Crisis management and crisis communication plan can be also an integral part of the risk responses.

*4. Review and Revision:*

A bank-wide approach to monitoring reputational risks should be adopted. Key risk indicators (KRI) and key control indicators (KCI) involved in ERM should be designed to include reputational risk and thresholds should be set. Internal roles and responsibilities for monitoring reputational risks should be defined. The monitoring process of reputational risks should primarily focus on areas of high inherent risk and prioritize the management of risks in these areas. Escalation processes should be established for exceeding thresholds, root cause analyzes should be performed, and not only realized risks, but also potential risks should be taken into account in the monitoring process.

A structured process in which internal events related to reputational risk are collected and recorded should be established within the bank. This process should include stages such as collecting, reporting and creating action plans for internal events. Thresholds should be determined, internal events should be segregated according to their materiality levels, and actions should be taken to minimize the effects on the bank following the occurrence of the events. It should be reviewed periodically to reflect changes in the entity's reputational risk management framework and risk appetite. First, second-, and third-line responsibilities should be defined in the processes for collecting, documenting, analyzing, reviewing and reporting internal events. Collected internal event data should be categorized and dated, gross and net losses, and root causes are identified. In addition, loss events due to reputational risk should also be classified according to business lines and loss types. Besides financial effects, non-financial effects should also be taken into account. Internal data collected should provide input to other risk management tools such as RCSA, scenario analysis and capital planning. Structured action planning processes regarding reputational risk loss events should be established, roles and responsibilities in these processes should be determined, implementation levels of action plans should be monitored and approval processes should be established for action plans to be closed.

*5. Information, Communication and Reporting:*

A process for reporting reputational risks should be established so that reputational risk performance can be regularly monitored throughout the bank. The frequencies, contents and report recipients of the reports to be made during the reporting process should be defined. A hierarchical structure for reporting should be established, and it should be determined to which level of management and when the information of which content will be reported. In the reporting process of reputational risks, internal roles and responsibilities should be defined and documented. The inherent and residual risks that are prominent in the reporting process should be included, information should be provided on the aspects of the risks, risk appetite thresholds should be specified, KRI and KCIs should be included, and significant reputational risk loss events and root causes should be specified. Once COSO principles are adopted to reputational risk, reputational risk management attributes, values and criteria can be defines as presented in Table 2.

**Table 2.** Suggested Attributes, Values and Criteria for the Reputational Risk Management

<table>
<tr><th rowspan="2">Attributes</th><th colspan="5">Values</th><th></th></tr>
<tr><th>0</th><th>1</th><th>2</th><th>3</th><th>4</th><th>5</th></tr>
<tr><td>1. Governance and Culture</td><td>No reputational risk perspective.</td><td>Reputational risk perspective is not integrated with governance and culture.</td><td>Reputational risk perspective and governance/ culture relation is weak.</td><td>Reputational risk perspective and governance/ culture relation is moderate.</td><td>Reputational risk perspective and governance/ culture relation is strong.</td><td>Reputational risk perspective is an integral part of governance and culture.</td></tr>
<tr><td>Criteria:</td><td colspan="6">• Designed governance structure<br>• Defined roles and responsibilities<br>• BoD’s responsibilities in risk monitoring<br>• Committee structure and responsibilities<br>• BoD’s and Committee members’ knowledge and expertise<br>• Documented and approved actions<br>• Defined risk governance framework<br>• Reputational risk awareness<br>• Qualified personnel<br>• Determined reputational risk behaviours<br>• Determined actions against violations of reputational risk behaviours<br>• Well-positioned internal audit</td></tr>
<tr><td>2. Strategy and Objective Setting</td><td>No reputational risk perspective.</td><td>Reputational risk perspective is not integrated with setting strategy and objectives.</td><td>Reputational risk perspective and strategy/ objectives relation is weak.</td><td>Reputational risk perspective and strategy/ objectives relation is moderate.</td><td>Reputational risk perspective and strategy/ objectives relation is strong.</td><td>Reputational risk perspective is an integral part of setting strategy and objectives.</td></tr>
<tr><td>Criteria:</td><td colspan="6">• Defined reputational risk management strategy<br>• Defined reputational risk management processes<br>• Defined reputational risk appetite framework<br>• Defined reputational risk appetite metrics<br>• Formulized business objectives considering reputational risks</td></tr>
<tr><td>3. Performance</td><td>No reputational risk perspective.</td><td>Reputational risk perspective is not integrated with performance.</td><td>Reputational risk perspective and performance is weak.</td><td>Reputational risk perspective and performance is moderate.</td><td>Reputational risk perspective and performance is strong.</td><td>Reputational risk perspective is an integral part of performance.</td></tr>
<tr><td>Criteria:</td><td colspan="6">• Documented reputational risk identification framework<br>• Defined sources of reputational risk<br>• Collected information about reputational risk sources<br>• Documented risks and existing controls<br>• Assessed controls<br>• Performed risk assessment practices including reputational risks<br>• Calculated inherent and residual risks<br>• Prepared action plans<br>• Organized bank-wide trainings<br>• Planned crisis management and crisis communication</td></tr>
<tr><td>4. Review and Revision</td><td>No reputational risk perspective.</td><td>Reputational risk perspective is not integrated with review and revision.</td><td>Reputational risk perspective and review and revision relation is weak.</td><td>Reputational risk perspective and review and revision relation is moderate.</td><td>Reputational risk perspective and review and revision relation is strong.</td><td>Reputational risk perspective is an integral part of review and revision.</td></tr>
</table>

| | | | | | | |
|---|---|---|---|---|---|---|
| *Criteria*: | • Defined key risk indicators and key control indicators<br>• Defined roles and responsibilities for reviewing reputational risk management components<br>• Defined roles and responsibilities for revising reputational risk management components<br>• Structured process related to reputational risk review and revision | | | | | |
| **5. Information, Communication and Reporting** | No reputational risk perspective. | Reputational risk perspective is not integrated with information, communication and reporting. | Reputational risk perspective and information/ communication/ reporting relation is weak. | Reputational risk perspective and information/ communication/ reporting relation is moderate. | Reputational risk perspective and information/ communication/ reporting relation is strong. | Reputational risk perspective is an integral part of information, communication and reporting. |
| *Criteria:* | • Defined process for reporting reputational risks<br>• Monitored reputational risk management performance | | | | | |

Source: Prepared by the authors based on the adaptation of the COSO ERM framework

The scoring of reputational risk management attributes and values can result in a score between 0 and 165. This numerical representation can be used to define a bank's level of maturity in reputational risk management. To obtain a qualitative score, five levels are defined with their explanations and score ranges are presented in Table 3 below. While creating these score ranges, the method used by Bak and Jedynak (2023) was taken into account and the threshold values of the intervals were obtained by dividing the total maximum score by the number of maturity levels.

**Table 3.** Proposed Reputational Risk Management Maturity Levels and Score Ranges

| Reputational Risk Management Maturity Level | Explanation | Score Range |
|---|---|---|
| Poor | There is little evidence that reputational risk is taken into account in the Bank's corporate risk management processes. | 0-33 |
| Basic | Basic processes related to the management of reputational risk are implemented. | 34-66 |
| Good | A reputational risk management approach is in place to meet internal and external requirements, but not integrated into general risk management practices. | 67-99 |
| Professional | Reputational risk is managed professionally at a level that generally meets with expectations, but not a fully integrated part of general risk management practices. | 100-132 |
| Excellent | Reputational risk management is managed in an integrated manner, continuous improvement is adopted and constitutes good practice for other banks. | 133-165 |

Source: Prepared by the authors based on the adaptation of Bak and Jedynak (2023)

## 6. CONCLUSION

Corporate reputation can be defined as the perceptions of third parties towards a business. It is one of the most important indicators of the prestige of businesses. It is an intangible asset that is acquired as a result of the activities and relationships of the business over the years, protects the businesses against external threats, but it is not that difficult to lose.

One of the most important values of banks is their corporate reputation. Reputational risk in banks often arises as a result of negative perceptions of shareholders, stakeholders, customers, competitor banks or legal authorities about banks. As a result of the reputational risk, trust in banks may be damaged and banks may be adversely affected financially. For this reason, the identification and effective management of those risks enables reducing the probability of losses due to reputational risk.

Since reputational risk can be considered as an intangible asset, it is extremely difficult to measure it. At this point, rather than measuring the reputational risks of banks, the evaluation of the maturity level of the reputational risk management comes to the fore. Reputational risk management maturity level indicates to what extent banks integrate reputational risks into corporate risk management processes and how effectively they perform reputational risk management on paper. A high level of reputational risk management maturity will not eliminate all potential reputational risk losses. On the other hand, it will contribute to reducing the possibility of banks to face such losses and minimizing the potential impacts of these losses.

The aim of this study is to propose a framework for the evaluation of banks' reputational risk management maturity levels. For this purpose, 5 attributes were determined, the values for the grading of the attributes In addition, 5 maturity levels were determined and score ranges were defined for each.

Using the framework proposed in this study, banks can make their own self-assessments in terms of reputational risk management maturity level. Moreover, evaluations can also be made for banks by using this framework by legal authorities. In addition, with this framework, it can be determined for which criteria remedial actions should be taken and the progress of the bank maturity level can be monitored periodically. Also, bank comparisons can be made by legal authorities using this framework.

The contribution of this study to the literature is that it proposes a framework for the evaluation of banks' reputational risk management maturity levels, defines criteria for this purpose, and suggests a framework. In the coming periods academic studies can be conducted with a similar perspective for different risk types, especially for operational risk.

**YAZAR(LAR) BEYANI / AUTHORS' DECLARATION:**

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**YAZAR KATKILARI / AUTHORS' CONTRIBUTIONS:**

Kavramsallaştırma, orijinal taslak yazma, düzenleme – **Y1** ve **Y2**, veri toplama, metodoloji, resmi analiz – **Y1** ve **Y2**, Nihai Onay ve Sorumluluk – **Y1** ve **Y2**. / Conceptualization, writing-original draft, editing – **Y1** and **Y2**, data collection, methodology, formal analysis – **Y1** and **Y2**, Final Approval and Accountability – **Y1** and **Y2**.

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