FINANCIAL SERVICES

Willis

ALERT

January 2011 – Issue 17 www.willis.com

PRESERVING YOUR REPUTATION

Maintaining a reputation is hard. Failure to do so can be catastrophic. The insurance industry is proficient at helping clients defend against executive risks or loss of property. More challenging, however, is safeguarding an organization's reputation. A good broker can help.

THE POTENTIAL RISK

According to the Bank of International Settlements in Basel, reputational risk is defined as:

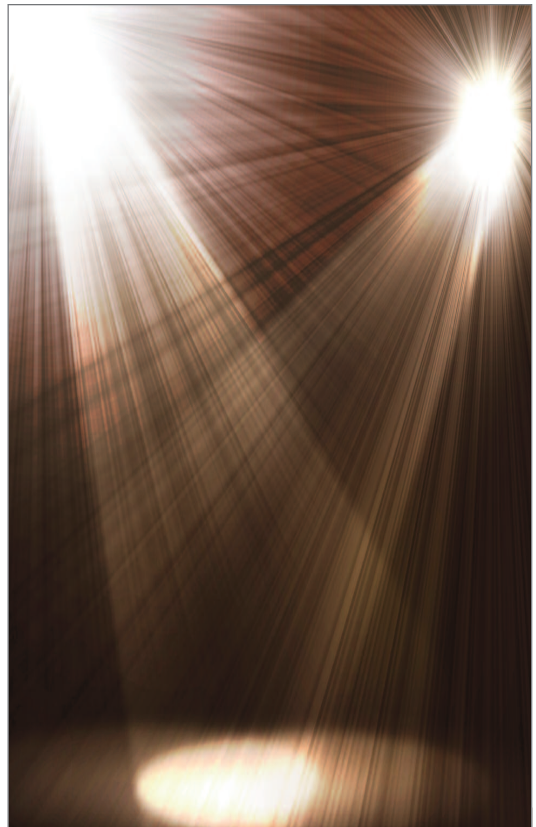
> *"the risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding."*[1]

The Federal Reserve puts it more succinctly, stating simply that reputational risk is:

> *"the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions."*[2]

REPUTATIONS ARE CRITICAL TO FINANCIAL INSTITUTIONS

All companies endeavor to build a solid reputation, but financial institutions are unique in the level of trust demanded of them. While corporations may seek investment from individuals or entities, financial institutions seek to become the holder and manager of another's financial wealth, often in a fiduciary role. A tarnished reputation can quickly ruin a bank, fund manager or insurance company.



Glass, china, and reputation are easily cracked, and never well mended.

– Ben Franklin

It takes twenty years to build a reputation and five minutes to destroy it.

– Warren Buffet

MEASURING LOSS: PUTTING A PRICE ON ONE'S GOOD NAME

If, as the Fed asserts, a damaged reputation can result in a decline in customer base, costly litigation and reduced revenue, it is certainly a risk worth insuring against.

The insurance industry has long understood that for a risk to be insurable the nature of the loss must be definite and financially measurable. There should be no room for argument as to whether or not payment is due, nor as to what amount the payment should be. Measurability is where insuring reputation becomes complicated.

Companies spend years and enormous sums of money developing logos and brand names. While recent scandals and disclosures have taught us about the financial cost of a damaged reputation, they have also highlighted the difficulty in measuring the total monetary value of that loss.

REPUTATION AND THE BOTTOM LINE

A good reputation helps a financial institution in a myriad of practical ways:

1. Investors and business partners are more likely to take risk in an admired institution.
2. Customers and suppliers are more loyal to a well-regarded company.
3. Recruiting is easier.
4. Employees are more loyal to a company with a good reputation.
5. Regulators may focus less burdensome scrutiny on institutions with sterling reputations.
6. Rivals are less anxious to compete with a respected institution.

A NEW THREAT TO YOUR REPUTATION – THE INTERNET

The advent of the internet means that information travels faster than ever before. It also means that virtually anyone can report "news"...or make allegations. Wikileaks has demonstrated that with little more than a computer and an internet connection it is possible to distribute reputation-destroying information worldwide in a matter of seconds.

THE HARSH REALITY OF INSURING REPUTATION

AT THE ROOT OF THE PROBLEM

Reputational risk exists throughout the organization and exposure to reputational risk is essentially a function of the adequacy of an institution's internal risk management processes, as well as the manner and efficiency with which management responds to external influences on company-related transactions.

LACK OF DIRECT COVERAGE

While a few insurance carriers have attempted to introduce reputational coverage,[3] their offerings have generally been extremely limited and less than practical for large institutions. The truth is, there is no magic potion insurance policy that can repair a damaged reputation. The reasons for this are two-fold: the inability to accurately measure the damages, as mentioned, and the convention that one's reputation cannot be tarnished without some culpability on the part of the injured; i.e., most people believe that where there's smoke, there's fire.[4]

MITIGATING REPUTATIONAL DAMAGE

BEFORE THE EVENT

Identify Exposures
An institution should identify potential sources of reputational risk. These include business lines, liabilities, affiliated operations, off-balance sheet vehicles and the markets in which it operates. Risks that might arise should be addressed in the institution's risk management processes and appropriately incorporated in its liquidity contingency plans.

Assign Responsibility
The appropriate individual or committee should be charged with overall accountability for planning and responding to reputational events. Most financial institutions place responsibility for reputational risk with their Risk Committees. Top institutions integrate reputation risk management directly into their risk and compliance manuals. (See inset)

JPMORGAN CHASE & CO.
RISK POLICY COMMITTEE CHARTER [ABRIDGED]

MISSION
The Risk Policy Committee is responsible for oversight of the CEO's and senior management's responsibilities to assess and manage the corporation's credit risk, market risk, interest rate risk, investment risk, liquidity risk and reputational risk...

AUTHORITIES AND RESPONSIBILITIES
... the Risk Policy Committee shall:

- **review with management guidelines and policies to govern the process for assessing and managing such risks...**
- **receive and review reports from management of the steps it has taken to monitor and control such exposures.**
- **review management's performance against these policies and benchmarks.**

The Risk Policy Committee shall review, at least annually, the committee's charter and recommend any proposed changes to the Board for approval. The Risk Policy Committee shall prepare, and report to the Board the results of, an annual performance evaluation of the committee, which shall compare the performance of the committee with the requirements of this charter.

Establish an Effective Internal Whistle Blowing Procedure
An attack on an institution's reputation rarely comes as a surprise. Someone within the organization knew something. Make sure that the lines of communication are open and that staff are encouraged to come forth with potentially damaging information.

The way to gain a good reputation is to endeavor to be what you desire to appear.

– Socrates

Integrate Communications Strategies

The right message delivered promptly by the right people to the right audiences is absolutely critical in a crisis. Make sure that there is a cohesive plan delineating who speaks for the institution at such a time. Preparation of a communication strategy will save valuable time when a problem arises.

Include the Financial Cost of Reputational Damage When Calculating the Institution's Monetary Risk

The value of a reputation is difficult to measure, but it would be rash to ignore the potential cost associated with responding to reputational crisis. Even rough estimates will make management more cognizant of the very real danger associated with a damaged reputation. It will also make getting approval to spend earmarked funds easier once a crisis hits.

AFTER THE EVENT HAS OCCURRED

Remain Calm

No matter how serious the crisis your advance planning will reduce the ensuing panic and show you the road ahead.

Put the Event in Perspective

Some events are newsworthy for a day and forgotten tomorrow; others may destroy a company's reputation forever. Before determining your institution's response, quickly gather a consensus on the scale of the risk you are facing. Some events are best ignored, others settled quietly. On occasion, your firm may need to fight publicly. It is important to have a plan in advance as to who will make that final response determination and who will be asked for input. Willis can help you determine the potential elements of such a crisis: the scale, the cost of the risk and the cost associated with legal settlements.

If the Event Is Likely to Result in Litigation, Call Your Insurance Broker

Involve your broker and the claim specialists at Willis early in the process. If it is necessary to engage counsel it is critical to know which, if any, costs are covered by existing policies. These advocates can be a valuable resource and are there to help mitigate damage to your institution. Your matter will be managed with the same professionalism and confidentiality that Willis brings to all of our clients' affairs.

See to Your Liquidity

Financial institutions must pay particular attention to the effects of reputational risk on their overall liquidity position. One of the main lessons from the failure of Lehman Brothers was how quickly commercial paper markets can dry up for an issuer. Should the loss of reputation result in various counterparties' loss of confidence, your institution may be facing restrictions on funding along with falling assets. It is critical that your short-term funding sources not dissipate in the event of a crisis involving reputation.

CONCLUSION

Corporate reputations are valuable assets. Damage done to a company's reputation is difficult to measure. With careful planning and attentive management, financial institutions can avoid or at least mitigate reputational risk.

Willis can be a valuable partner when facing a reputational crisis. A well-timed call to your broker and decisive action can help minimize the impact of an event that could otherwise seriously harm your firm's image.

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[1] http://www.bis.org/publ/bcbs157.pdf?noframes=1

[2] http://www.federalreserve.gov/boarddocs/SupManual/cbem/1000.pdf

[3] Some Cyber policies now cover risks associated with reputation risk. For example, The Hartford now offers broader coverage for data privacy breaches and social media liability exposures, such as online defamation, advertising, libel and slander, by employees or casual users of a company's website. In addition, some D & O policies offer "crisis management" coverage, which provides a sub-limit for costs associated with retaining public relations firms to assist in managing a crisis.

[4] While an institution's reputation may be injured by lies or falsehoods, these will generally be grounds for an action against the perpetrator.