Consultation for Proposed Reputational Risk Management Module (RR)

Industry Comments and Feedback
June 2018

General Comments:		
Comments	**REF**	**CBB Response**
<u>A Bank:</u> We recommend adding a clarification on the applicability of reputational risk management module on Overseas Conventional Banks, noting that some of the requirements are not applicable to Branches of Foreign Conventional Banks specifically section PR-3.4 which is related to Step-in Risk.	GR-1	Step-in risk is applicable to Locally incorporate banks only. Amendment made to the rulebook to reflect this scope exclusion under RR-A.1.4.
<u>A Bank:</u> We recommend clarifying the scope of implementation on Wholesale and Retail banks.	GR-2	Scope of application is defined under RR-A.1.3. The module is applicable from the date of issue. However adequate time allowed for reporting Step in risk.
<u>A Bank:</u> We recommend providing a reasonable transitional period to enable banks to apply the new requirements form the date of publishing the new requirements.	GR-3	See revised timelines for submission of reports in the finalized rules.
<u>A Bank:</u> Guidance on Reputational Risk Quantitative measures is required.	GR-4	A measurement approach is yet to be defined by Basel. Best practices must be followed.
<u>An Audit Firm:</u> The module calls for banks to measure losses (related to reputational risk) that might be experienced under adverse market conditions. Reputational risk in our view is a risk that ultimately manifests in multiple risks such as liquidity and funding risk, asset growth and business risk, ability to issue capital instruments, etc. The impact of reputational risk may be observed in a bank's ability to further grow assets, ability to raise capital and access funding, ability to hedge with derivative counterparties, ability to arrange insurance coverages and cost of premiums, etc. CBB may consider providing more guidance in terms of assessing reputational risk under idiosyncratic and systemic adverse conditions. For example, the following direct impacts could be prescribed as a consequence of an 'reputational' event(s): ➢ Run-off rates on Retail/Corporate/Inter-Bank deposits (x%, y%, z%) ➢ Higher cost of funding to maintain liquidity (e.g. min x% or higher)	GR-5	Applying a 'standardized' approach to quantify/measure reputational risk is not practical given the difference in each Bank's risk profile and activity.

➢ Decline in assets growth (e.g. x% - y%) ➢ Inability to raise AT1/T2 capital instruments or raising these at a premium cost ➢ Cost of OTC hedging (e.g. min x% extra cost) ➢ Raise of all insurance premiums x% In addition, the requirement for banks to conduct stress testing or scenario analysis to assess any secondary effects of Reputational Risk is a challenging request. CBB may consider changing “any” to “material”.		
A Bank: Key concerns regarding Reputational Risk Management guidelines are given below and more details are provided in the Annexure. a) The guidelines are not providing a prescriptive on how to assess reputation risk exposure and quantify potential loss (only illustrative performance indicators / EWIs have been provided, without providing basis for linking to the exposure). These are not practiced comprehensively even by GSIBs at this stage and therefore, the banks in Bahrain will not have any guidance from international best practices. b) While no timeframe has been suggested, we feel that a lot of time and resources will be needed on internal discussions on the modalities and also possible external assistance for the implementation. Hence, the time for implementation should be reasonable. Even the implementation / reporting dates e.g., for step-in risk, should be lengthened.	GR-6	a. Refer to GR-4 b. Refer to GR-3
A Bank: We certainly appreciate the CBB taking the lead on this strategic and highly sensitive area of risk management. We are also pleased to note that we are generally in compliance and in agreement with the rules and guidelines provided by the CBB. Considering the scope of the module, we recommend that the module be made applicable from 1st January 2020.	GR-7	Noted. Please refer to GR-3 for transition period.
A Bank: - Rep risk is non-quantifiable in our view, therefore difficult to guess or estimate impact on other risks. - We agree with proactive management, establishment of governance frameworks, policies, conduct etc (which we already have plenty of). - As rep risk is not quantifiable, it’s difficult to incorporate in stress testing but would be happy to use some overlay on our regular stress testing unless the CBB has more specific guidelines - Section 3.3 is missing.	GR-8	Please refer to GR-4 Section HC-3.3 was numbered as HC-3.4 and has been renumbered back to HC-3.3.

Step-in Risk: It will be appreciated if the CBB provide further clarity on: - The definition of "unconsolidated entities". - The scope of the consolidation. And is this limited to local entities? - The type of entities and relationships that banks should consider for the purpose of assessing this risk. - Guidance on the required self-assessment specified in section RR- 3.4.3. Is the report mandatory even if the risk does not exist? - Does this apply to a branch of a foreign bank?		
A Bank: The Brand Values and Conduct Committee (BVCC) is the Bank's Board level oversight committee for reputational risk. Reputational risk is a standing agenda item for each BVCC meeting.	GR-9	Noted
A Bank: The Bank takes the management of reputational risk very seriously and has had a reputational risk policy for many years. We are currently revising it to reflect updates to our framework following a change in second line ownership of reputational risk. Ownership of Reputational Risk as a principal risk type moved from Corporate Affairs to Enterprise Risk Management. The Risk Framework owner moved from being the Group Head, Corporate Affairs to the Group Chief Risk Officer with day to day responsibility delegated to the Global Head, Enterprise Risk Management. In country, prior to the switch, this authority had been delegated to the Country Head, Corporate Affairs and this has now moved to the Country Chief Risk Officer. • We clearly differentiate between primary reputational risks where the Group makes strategic choices or decisions whilst considering reputational risk at the point of decision making; and secondary reputational risks arising from the potential failure of another risk-type. • For primary reputational risks, this is segmented into three broad areas: Clients, Products, and Transactions – the business we choose to do. • Reputational risks are assessed by considering the potential negative views of seven stakeholder groups: Media; Regulator; Client; Investor or Analyst; Government agency or public sector; NGO; Employee, using a materiality assessment matrix in order to enhance consistency in risk identification as well as a tiered risk-taking authority matrix,	GR-10	Noted

depending on severity, for risk acceptance. • Reputational risks assessed as High or Very High are sent to the Group Reputational Risk Committee. Medium Reputational Risks can be accepted at the regional level and Low and Very Low at the country level. • Overarching thematic issues and risks are monitored and reported by the individual function responsible for the risk. • Everyone in any organisation has a role to play in identifying and escalating reputational risk. But in a large multi-national company with tens of thousands of employees, robust governance is needed to ensure this is done effectively.		
<u>A Bank:</u> The Bank takes the management of reputational risk very seriously and has had a reputational risk policy for many years. We are currently revising it to reflect updates to our framework following a change in second line ownership of reputational risk.	GR-11	Noted
<u>A Bank:</u> Assessment of reputational risk stress testing: The Bank conducts Enterprise wide stress tests taking into account various scenarios.	GR-12	Noted
<u>A Bank:</u> Management of step-in risk: The Bank takes the management of reputational risk very seriously and has had a reputational risk policy for many years. We are currently revising it to reflect updates to our framework following a change in second line ownership of reputational risk.	GR-13	Noted
<u>A Bank:</u> a. The module stipulates at the outset that it applies to all conventional bank licensees. However, some of the provisions refer to the board etc. and would therefore not be applicable at a branch level. Also, the set-up, sizes and activities of branches of overseas banks vis-à-vis locally incorporated banks could differ significantly. Therefore, it would be advisable if the module takes this distinction into consideration and, pursuant to other modules, stipulate appropriately divergent requirements for branches of overseas banks vis-à-vis locally incorporated banks; b. Should CBB decide not to incorporate divergent requirements for branches of overseas banks vis-à-vis locally incorporated banks, would it be acceptable for these branches to rely on their head office relevant procedures, assessments, testing and reports (cf. RR 3.1, .3.2 and 3.4) provided these measures also accommodate CBB requirements;	GR-14	(a) In the case of branches, references to the board etc. should be interpreted as the head office board etc. (b) Yes, however, the branch must show that it is compliant with the rules at the branch level.

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RR-A.2.1 This Module was first issued in April 2018 as part of Volume One of the CBB Rulebook. All directives in this Module have been effective since this date. Any material changes that have subsequently been made to this Module are annotated with the calendar quarter date in which the change was made. Chapter UG-3 provides further details on Rulebook maintenance and version control.	**A Bank:** Typo correction: reference should be made Volume Two instead of Volume One.	SP-1	Noted and corrected.
RR-1.1.3 Reputational risk also may affect a bank's liabilities, since market confidence and a bank's ability to fund its business are closely related to its reputation. For instance, to avoid damaging its reputation, a bank may call its liabilities even though this might negatively affect its liquidity profile. This is particularly true for liabilities that are components of regulatory capital, such as hybrid/subordinated debt. In such cases, a bank's capital position is likely to suffer.	**A Bank:** **RR-1.1.3**: It is provided 'For instance, to avoid damaging its reputation, a bank may call its liabilities even though this might negatively affect its liquidity profile.' This provision needs to be reviewed and further clarity provided.	SP-2	No change required.
RR-1.1.4 Once a bank identifies potential exposures arising from reputational concerns, it should measure the amount of support it might have to provide (including implicit support of securitisations) or losses it might experience under adverse market conditions. In particular, in order to avoid reputational damages and to maintain market confidence,	**A Bank:** It would be very helpful if CBB provides detailed guidelines for the Methodologies mentioned in this section.	SP-3	Banks should determine the most suitable approach to comply with requirements in the Module. See also RR-3.1.1 and RR-3.1.9.

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a bank should develop methodologies to measure as precisely as possible the effect of reputational risk in terms of other risk types (e.g. credit, liquidity, market or operational risk) to which it may be exposed. This could be accomplished by including reputational risk scenarios in regular stress tests. For instance, non-contractual off-balance sheet exposures could be included in the stress tests to determine the effect on a bank's credit, market and liquidity risk profiles. Methodologies also could include comparing the actual amount of exposure carried on the balance sheet versus the maximum exposure amount held off-balance sheet, that is, the potential amount to which the bank could be exposed.			
RR-3.1.8 The following elements must be included in the banks' governance practice framework: **(a) Setting a clear and unambiguous vision, values, goals and strategies, and ensuring that they are transparent;** **(b) Developing appropriate policy, codes of conduct, guidelines and procedures to support the implementation of the bank's vision, values, goals and strategies;** **(c) Creating an open and empowering corporate culture to encourage**	**<u>A Bank:</u>** Contents of this section is more suitable for the High Level Control module.	SP-4	RR-3.1.8 complements the corporate governance requirements defined in Module HC, moreover it draws reference to the requirements under RR-3.1.4.

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responsible and ethical behaviour, and to support the achievement of business objectives and effective risk management; **(d) Building up a strong, stable management team that are honest, competent, responsible, accountable and responsive to stakeholders;** **(e) Raising the risk awareness of employees and providing employees with adequate training;** **(f) Setting up effective systems and controls to manage and control all material risks (including reputational risks) faced by the bank and to monitor compliance with all applicable laws, regulatory standards, best practices and internal guidelines; and** **(g) Having adequate policy and procedures in place to ensure that all disclosures to stakeholders are clear, accurate, complete, relevant, consistent and timely, and guided by the principles of ethics, integrity and transparency.**			
RR-3.1.9 Banks must have adequate arrangements, strategies, policy, processes and mechanisms in place to manage reputational risk. An effective reputational risk management process must include:	**<u>A Bank:</u>** (c) Would this need to be quantitative or setting a qualitative risk appetite for reputational risk suffice?	SP-5	See SP-3. Banks must decide the nature of measures.

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(c) Addressing reputational risk in a precautionary manner, for example by setting limits or requiring approval for allocating capital to specific countries, sectors or persons and/or whether its contingency plans address the need to deal proactively with reputational issues in the event of a crisis;			
RR-3.2.1 Banks must conduct a regular assessment of the reputational risk to which they are exposed, leveraging their understanding of governance, business model, products and the environment in which they operate.	**<u>A Bank:</u>** How often is regular? Will a semi-Annual review with the use of Risk Control Self-Assessment (RCSA) as a toll be sufficient?	SP-6	'Regular' should be interpreted in the context of nature, size and risk exposures to the bank.
RR-3.2.2 Banks must consider both internal and external factors or events that might give rise to reputational concerns (refer to Section RR-2.1). Banks must consider the following qualitative indicators, amongst others, in their assessment of reputational risk: **(a) The number of sanctions from official bodies during the year;** **(b) Media campaigns and consumer-association initiatives that contribute to a deterioration in the public perception and reputation of the institution;** **(c) The number of and changes in**	**<u>A Bank:</u>** RR-3.2.2 Qualitative Assessment of Reputational Risk may be linked with the Key Drivers.	SP-7	The requirement refers to the minimum qualitative indicators to be considered as part of the qualitative assessment of RR, whilst key drivers should be considered for monitoring RR.
	<u>A Bank:</u> RR-3.2.3 seems more of a correlation among different risk disciplines and categories. It is suggested that some quantification methodology must be suggested by CBB to bring about uniformity among different banks.	SP-8	Refer to GR-4
	<u>A Bank:</u> Some quantitative methodologies should also be suggested before Stress Testing. Before RR-3.2.4.	SP-9	Refer to GR-4

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customer complaints; **(d) Malpractices and irregularities;** **(e) Negative events affecting the institution's peers;** **(f) Dealing with sectors that are not well perceived by the public (e.g. weapons industry, embargoed countries etc.) or people and countries on sanctions lists; and** **(g) Other 'market' indicators, for example, rating downgrades or changes in the share price throughout the year.**			
Stress Testing **RR-3.2.4 Banks must enhance their stress testing methodologies to capture the effect of reputational risk. Banks must also conduct stress testing or scenario analysis to assess any secondary effects of reputational risk (e.g. liquidity, funding costs, etc.).**	**A Bank:** For Stress testing CBB may consider to provide an illustrative list of Shock categories for Liquidity or Reputational Risk which would be used by Banks accordingly	SP-10	Guidance on the development of stress scenarios are defined under RR-3.2.4. An illustrative list would need to include capture various and diverse scenarios to capture the different operational environment, activities and risk profile of the Banks. Banks should exercise their best judgment and apply stress scenarios and parameters that suit their own circumstances and risk profile.
RR-3.2.6 Banks should be guided by the following supplementary guidance on use of stress testing for reputational risk: (c) Banks may face reputational risk in other aspects, such as those arising from material	**A Bank:** RR-3.2.6. c) Is linked with Frauds and weak Internal Controls, this point can be linked or align with if available Risk Control Self-Assessment under Basel regime exercise or Risk Control Metric exercise	SP-11	RR-3.2.6 addresses the need to assess the impact of fraud and weak internal controls from a reputational risk impact.

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weaknesses in their internal risk management processes (e.g. resulting in substantial fraudulent losses) or management's failure to respond swiftly and effectively to external threats or influences (e.g. resulting in poor strategic decisions). Banks should exercise their best judgment and apply stress scenarios and parameters that suit their own circumstances and risk profile;	under COSO Framework.		
RR- 3.4.1 Banks must establish and maintain, as part of their risk management framework, policy and procedures that describe the processes used to identify entities that are unconsolidated for regulatory purposes and the associated step-in risks. The policy and procedures must: **(a) Clearly describe the identification criteria that banks use to identify the step-in risk;** **(b) Not be prescriptive or geared towards any particular type of entity. Given the case-by-case nature of the evaluation, the guidelines are envisaged as flexible enough to capture all entities that are unconsolidated for regulatory purposes and which pose significant step-in risk;** **(c) Clearly describe the specific provisions of the laws or regulations and list the types**	**<u>A Bank:</u>** **<u>RR 3.4.1:</u>** For avoidance of doubt it needs to be confirmed that Step-in risk shall not be applicable for consolidated entities.	SP-12	Step-in risk applies to unconsolidated entities as prescribed by the Basel Committee in their publication #423 "*Guidelines: Identification and management of step-in risk*".
	<u>A Bank:</u> Suggest the CBB to define what constitutes as connected but unconsolidated entities (the relationship) with regards to "Step-in risk".	SP-13	In some cases, banks preferred to support certain shadow banking entities in financial distress, rather than allow them to fail and face a loss of reputation, even though they had neither ownership interests in such entities nor any contractual obligations to support them. Please refer to Module CM for definition of connected parties. Please also refer to SP-12
	<u>A Bank:</u> Is there a particular guideline(s) or Circular to properly identify and measure step-in Risk(s)?	SP-14	Each bank should determine the methodology and relevant criteria for assessment of reputation risk that is most suitable to the bank. The CBB is not, presently, intending to prescribe or mandate a certain approach or method for identifying

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of entity covered by those laws or regulations; **(d) Describe the internal function responsible for identifying, monitoring, assessing, mitigating and managing the potential step-in risk;** **(e) Clearly describe the bank's own definition and criteria of 'materiality', as used to exclude immaterial entities in the bank's step-in risk assessment, and their rationale;** **(f) Document the process to obtain the necessary information to conduct the regular self-assessments;** **(g) Be reviewed regularly, and whenever there is any material change in the types of entity or in the risk profile of entities; and** **(h) Require the 'Step-in Risk Self-assessment' to be included in the internal risk management processes, subject to independent controls.**			and measuring the step-in risk.
Regular Step-in Risk Identification and Assessment **RR- 3.4.2 Banks must regularly identify all entities giving rise to step-in risk. For all these entities, they must estimate the potential impact on their liquidity and capital that step-in risk could entail. The**	**<u>A Bank:</u>** For RR- 3.4.2 CBB may provide guidelines on estimation method / methodology for financial impact of Step-in risk.	SP-15	Refer to SP-14.

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bank must use the estimation method it believes to be most appropriate. Banks must describe the method used to estimate the financial impact of step-in risk in each case.			
Step-in Risk Reporting **RR- 3.4.3 Banks must annually report the results of their self-assessment of step-in risk to the CBB on 30th April of each year. The report must contain the following information:** **(a) Per groups of similar entities, the number and types of entity that were initially identified;** **(b) The entities must be grouped under three categories: entities deemed immaterial (for which no step-in risk assessment process conducted); entities which are material, but for which step-in risk is insignificant; and entities which are material and for which step-in risk is significant; and** **(c) The nature of the step-in risk and the action taken by the bank to limit, mitigate or recognise this risk, must be reported for entities which are material and for which step-in risk is significant.**	**A Bank:** **RR-3.4.3**: The Period of self-assessment of reputational risk required to be reported to CBB as at 30th April each year to be specified, ideally it should be the preceding calendar year.	SP-16	Banks must annually report the results of their self-assessment of step-in risk on 30th September of each year.
	A Bank: Suggest the CBB to consider dropping the mandatory annual reporting of the self-assessment of step-in risk, as this is time specific and will exhaust the resources of the bank, given our small size.	SP-17	Banks must report annually
	A Bank: **Step-in Risk Annual Reporting:** Section RR-3.4.3 requires all banks to annually report the results of their self-assessment of step-in risk to the CBB on 30th April of each year. The section also details the scope of submission. However, we recommend CBB formulate a standard template for submission of step-in risk reporting to ensure consistency in submission across all financial institutions. Also, we would recommend CBB provide a working example of self-assessment of step-in risk.	SP-18	No template is being made mandatory yet.

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	A Bank: For RR- 3.4.3 Sample format of reporting may be provided by CBB.	SP-19	See SP-18