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BANKTHINK

Reputational Risk Goes Beyond Press

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Anyone who's read a newspaper lately has seen plenty of advice for banks on the Libor matter: large banks should gird for prosecution and the benchmark's possible downfall; markets should get ready for a reasonable amount of confusion; managers should expect a wave of regulatory orders.

This sort of advice may or may not be warranted. But the recent headlines do hold a core lesson for every bank, big or small: reputation risk is worth your utmost attention.

Reputation is a misunderstood concept, too often confused with a company's advertising or PR strategy. It is something much broader: the faith that outsiders – from counterparties, to shareholders, to regulators – have in a firm's ability to conduct itself well. It's difficult to measure, because it is related to everything a company does in the public eye.

The costs of reputational damage, however, are real and measurable. In 2005 news broke that Riggs Bank would settle charges of money laundering violations – an act that might have, in an earlier era, raised market-cap prospects for the bank. But instead of encouraging investor confidence, the company's market capitalization fell 22%. When news of the "London Whale" losses broke, JPMorgan Chase's market capitalization fell by more than $20 billion, dwarfing the $2 billion to $3 billion loss then envisioned from the trade itself.

These are not the type of systemic events some say will emerge from the Libor matter. Instead, they are blows to individual companies, whose cost may even be higher than their effect on a company's ability to deal with the specific matter. A regulatory settlement or a Senate hearing can remove a cloud enveloping an institution but create deeper doubts than the ones it removes.

Reputation risk has long been a neglected driver of new regulation, but it has taken on a larger role. This has been a bruising year in the court of public opinion. The recent notorious matters have been institution-specific – not systemic, as they were during the financial crisis – and have not been accompanied by a market panic. That dynamic can be dangerous, though less obviously cataclysmic, giving casual observers a story that is easy to understand and easier to caricature. It serves up specific errors in sometimes lurid detail.

Reputational damage can be exacerbated by a stricter regulatory climate. Regulators too need the public trust. Gaining that trust means acting now with public concerns about banker behavior at a fever pitch. (That the ordinarily sober *The Economist* characterized London bankers as "Banksters" testifies to this.)

Bankers should expect and prepare for a tougher hand in the months to come, especially on compliance matters. The only proper way to respond is to double down on best practices. These include adopting a forceful tone at the top that emphasizes integrity, customers and adherence to regulations, creating an industrial strength compliance team and training program and keeping management engaged on emerging compliance and safety and soundness issues.

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