# GUARDING YOUR Reputation

— by JONATHAN SHIERY —

"It takes many good deeds to build a good reputation,
and only one bad one to lose it."
*—Benjamin Franklin*

**There are a million ways a financial services firm can see its brand tarnished in the public eye. Here are some tips on how to prevent that from happening.**

An institution's reputation has a critical connection to its intrinsic current value—as well as the ability to create or destroy its future value. Yet reputation does not appear as a line item on a balance sheet. Nevertheless, it generally represents a significant proportion of the difference between market value and book value. ¶ In the mortgage industry—where consumers are entering into a 30-year commitment linked to one of the most important financial decisions of their lives—reputation could arguably be a financial institution's single greatest asset. ¶ Although consumers do not choose their servicers, most servicing units are part of larger financial conglomerates offering multiple consumer products where enterprise reputation can be put at risk by any single line of business. ¶ So what exactly is reputational management? ¶ Reputational management is the practice of monitoring your institution through risk assessments of the firm's products, portfolio and operations to identify and remediate activities that are or may be damaging to the firm's reputation. Reputation risk assessments that include evaluation of customer complaints can often bridge the gap

between how a company perceives itself and how others view it.

When firms earn a favorable reputation as fiduciaries for their clients, they are often rewarded by consumers and investors alike. Investors and analysts deliver promising forecasts that increase share price, and consumers demand their products or services and recommend them to their network and share positive comments across social media.

Since the financial crisis and the subsequent five-year recovery, risks to reputation have become a preoccupation for financial institutions and their regulating entities.

London–based Aon plc's 2013 *Global Risk Management Survey,* conducted in fourth-quarter 2012, rated damage to reputation as one of the top three global business risks to financial institutions. However, an alarmingly high number—43 percent—of the survey's respondents said they were not prepared for reputational risk events.

> The response to a reputational crisis must be immediate and precise.

Reputational events often arrive with little or no warning, and have recently been the result of regulatory compliance and/or operational breakdowns in the mortgage line of business.

Damage to reputation can capture a wide range of activities in the mortgage industry, including originations; servicing; loss mitigation; consumer financial laws; fair lending; and unfair, deceptive or abusive acts or practices (UDAAP) regulatory requirements.

These risks include the possibility of a public enforcement action by the institution's regulators, class-action lawsuits and negative publicity. Due to the volume and velocity of complex laws and regulations, the risk of non-compliance has increased significantly.

Proactive mitigation of potentially damaging reputational events through rigorous planning, defined roles and responsibilities, and robust reputational risk assessment capabilities will be essential to protecting a brand.

In an age of on-demand information and social media access, 24-hour news cycles and ever-increasing political scrutiny, the response to a reputational crisis must be immediate and precise. Organizations are often forced to respond in real time, and respondents to the aforementioned 2013 Aon report say that financial losses have increased dramatically over the previous year.

This article will use the Consumer Financial Protection Bureau's (CFPB's) complaint data to identify three key risks to mortgage participants' reputation. It will then describe five reputational risk-mitigation activities that the mortgage industry can leverage to enhance reputational risk management to develop customer trust and create long-term value for the institution.

**Current state of the industry's reputation**

The entire financial industry and its institutions have experienced significant brand damage for practices that were considered unfair, abusive or deceptive. Regulators have responded with fines and settlements running into the billions of dollars. Servicing portfolio acquisitions have been blocked due to concerns that financial institutions lack the ability to handle volumes.

These types of headlines run daily in the media, and continuously chip away at a firm's reputation at a time when banking has been identified as the least-trusted industry, according to the Washington, D.C.–based Aspen Institute's Initiative on Financial Security.

It is more important than ever that financial institutions use available data to stay close to their customers and resolve escalating issues.

The CFPB's July 2014 report on its consumer complaint database—which collected more than 134,000 mortgage-related complaints from July 2011 through June 2014—offers telling information that can be leveraged to identify and proactively manage reputational risks.

The CFPB report provides three key takeaways that institutions can focus on improving as part of their brand's reputational management:

- Consumers continue to face challenges when they are unable to make their mortgage payments, such as issues related to loan modifications, collections or foreclosures. These types of complaints make up 56 percent of the accepted complaint submissions concerning mortgages.
- Payment processing, including escrow, and loan originations comprise 28 percent of the issues reported by consumers.
- Consumers have disputed more than 23 percent of the company responses to mortgage complaints.

This did not go unnoticed by the Office of the Comptroller of the Currency (OCC) in its *Semiannual Risk Perspective* report over the last year. In its spring 2013 report, the OCC stated that operational risk remains high across a spectrum of activities.

Internal control failures, breakdowns in operational processes and lapses in oversight control functions were significant contributors to a number of recent high-profile events, including defective mortgage foreclosure and settlement processes and inappropriate business practices.

Again, in its most recent publication, the spring 2014 *Semiannual Risk Perspective* report, the OCC reiterated the concern that operational risk remains high and communicated that its supervisory staff will continue to focus on assessing the corrective actions taken to address articles in the foreclosure consent orders, including strengthening operational processes and implementing any necessary upgrades to systems and processes to meet enhanced mortgage servicing requirements.

It continues to be critical for financial institutions to enhance reputational risk management capabilities around their products, portfolio and operations to accomplish the following objectives:

- Ensure that consumers understand the terms or conditions

of products and services;

- Understand the risks, costs and conditions of products that could be perceived negatively;
- Effectively control vendor relationships, including selection, contracts, continuous monitoring, human resource management, complaints handling and contingency planning;
- Confirm that consumers can reasonably avoid negative risks, costs and conditions;
- Clearly communicate the benefits of the product and note that they outweigh any perceived risks; and
- Identify and remediate any representations, omissions or inappropriate practices that may cause harm to the consumer, community and other stakeholders.

It is nearly impossible to accurately measure the probability and likelihood of damage from an event to financial institutions' share price, future earnings, customer acquisition and retention, and regulatory scrutiny.

As a result, mortgage industry participants will need to focus on adequate risk management frameworks, capacity to handle high transaction volumes, third-party management and making loss-mitigation servicing a priority at all levels.

It is time for institutions to make reputational risk management every employee's business, from the top down.

**Five steps to improve reputational management capabilities**

The most important step in managing reputational risk is the initial identification of factors that can impact reputation—either positively or negatively.

The cornerstone for a strong strategy is a three-dimensional approach that includes delivery of best-in-class mortgage products or services, customer satisfaction, and compliance with regulations and laws.

The following activities will enhance your reputational management capabilities to support a strong brand and client experience across all touch points.

***1. Make reputational risk management a priority across all levels.***

It is time for institutions to make reputational risk management every employee's business, from the top down. This includes executive directors; management; general counsel; the board; public relations; internal auditors; risk, compliance and insurance managers; information technology; business partners; and all other personnel.

For example, servicers should consider the reputational risks before pursuing new products, managing client relationships or executing business processes. If your servicing organization is part of a larger company, it is essential to have forums that break down communication barriers to ensure reputational risks are handled appropriately and consistently.

Reputational risk committees with defined escalation lines into senior management, clear policies, ongoing training and positive recognition when employees protect the firm's reputation are all ways to make this topic a priority at all levels.

Integrating reputational risk management into the culture of your organization will enable the business to proactively identify and mitigate potentially devastating reputational risks. Successful strategies materialize when risk managers across the lines of business collaborate to develop and deliver comprehensive and integrated risk profiles of organization-wide reputational risks.

Prioritize reputational risk through ongoing communication and recognition of individuals for identifying and raising reputational risks.

***2. Be proactive rather than reactive.***

Reputation is the consequence of your actions. If your reputation is poor and your performance is good, it is a failure in communication. If the reputation that reflects poor character or judgment is earned, it is the failure of risk management.

However, institutions cannot effectively manage reputational risks if they are unable to identify them proactively.

Some examples may be establishing strong reputational risk management policies and procedures, developing a comprehensive system of internal controls and practices, implementing independent and transactional testing on a regular basis, and establishing a crisis management team in case there is an event that holds potential harm to the company's reputation.

Institutions should be—if they are not already—investing in development of reputational risk management strategies that include robust controls across the mortgage value chain, particularly activities related to originations, payment processing and loss mitigation.

***3. Use data-driven, risk-based reputational management.***

Risk officers need to have access to solid data and reports that provide analytics to support key decisions around reputational risk management. It is important to collect data from your own organization and then supplement it with broader benchmark data to develop a solid, credible database for analysis.

An important component of this effort is careful analysis of the high-severity reputational events that may be triggered by your products, portfolio and operations.

Risk-based reputational management has numerous benefits. Institutions can customize risk management to effectively target and deal with their highest-priority risks that will most improve reputational outcomes and best control costs.

One example would be using customer complaint data internally or from the CFPB's database to drive reviews of business processes with the intent to identify areas of opportunity to enhance effectiveness.

***4. Partner with an independent risk firm to complete reputational scenario analyses and assessments.***

trends, business strategy and external industry events (e.g., potential litigation, business practice risks and issues experienced by competitors) to complete reputational risk assessments can provide valuable insights that reduce surprises, costs and/or losses associated with reputational risks.

One common area where independent teams can provide value is in regulatory mock examinations.

With the CFPB mortgage servicing standards taking effect this year, mock exams by independent parties can identify areas where firms may not be in compliance and are exposed to settlement fines and other events that might harm their reputation.

Independent firms can provide assessments by reviewing reputational risk from a strategic (e.g., volume and types of assets under management), external (e.g., market's or public's perception of the servicer) and/or a management, processes and systems (e.g., past performance of new products, expertise in senior management, quality and integrity of management information systems, etc.) view.

These partners can help institutions quickly recognize potential risks, benchmark their reputation against peer institutions, be more proactive and forward-looking, and establish and implement appropriate responses.

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***5. Assess reputational risks across the whole value chain.***

A failure of one of your vendors can be just as devastating as an internal problem. Reputational risk controls can and should be harmonized among your vendor partners. Navigant recently published an article discussing the impacts that UDAAP have on vendor management for financial institutions.

A vendor's non-compliance with consumer laws and regulations, or poor performance by its operating system, creates reputational risk for a financial institution. Consequently, financial institutions should be especially vigilant in identifying, assessing, monitoring and mitigating this risk.

For example, if a third-party vendor erroneously forces lender-placed insurance on a borrower who has provided evidence of insurance, the lender can be subject to compliance penalties as well as reputational damage, which can have longer-lasting impact.

In a 2011 study by New York–based Weber Shandwick, *The Company Behind the Brand: In Reputation We Trust,* word of mouth appears to be the leading influence (88 percent) when examining what shapes consumers' opinion of a company—although online reviews (83 percent) and online search results (81 percent) are also highly influential, as are news sources (79 percent) and company websites (74 percent). This finding was further reinforced in an article in the October 2013 issue of *Mediterranean Journal of Social Sciences,* which concluded consumer-to-consumer communication is the primary factor behind up to 50 percent of purchasing decisions.

Every day headlines are full of stories about cyberthreats, servicing problems, discriminatory credit underwriting and violations of consumer financial protection laws. This barrage of negative stories continues to undermine the reputations of financial institutions. It's time to do something about it.

**Taking action**

Financial institutions can strategically manage their reputational risk by aligning the firm's purpose, goals, values, conduct and actions with the expectations and experience of their consumers, investors and regulators.

If recent CFPB fines, the National Mortgage Settlement and independent foreclosure reviews have taught us anything, it is that prevention is typically cheaper and less painful than corrective actions.

CFPB and OCC reports have identified key areas of concern around loss mitigation, payment processing and customer remediation that could have significant reputational impacts for servicers.

In January 2014, the OCC released a proposal setting forth new standards, based on the agency's heightened expectations program, for large national banks and federal savings associations that would be enforceable under part 30 of its regulations.

More specifically in regard to reputational risk, the OCC outlined the following guidelines:

- Banks should establish a formal, written framework that includes reputation risk.
- The framework must appropriately cover risks to the bank's reputation that arise from all of its activities, including risks associated with third-party relationships.
- Audit testing should require the evaluation of reputational risk.

These heightened expectations will likely require more resources, increased visibility and the integration of reputational risk management into the organization's culture at all levels.

Servicing organizations should use regulator data and communications proactively in order to create awareness around potential reputational risks throughout the servicing operation.

Financial institutions would be well served to keep an open dialogue that continually asks how the mortgage organization can be fiduciaries for its customers, communities and the firm's brand.

Measure your reputational risk management policies by their results, not their intent. It will pay big dividends and put your reputation first. **MB**

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