

ASSESSING REPUTATIONAL RISK: A FOUR POINT MATRIX

Ezelda Swanepoel*

North-West University

Gary van Vuuren+

North-West University

Jánel Esterhuysen*

North-West University

Ronnie Lotriet**

North-West University

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Abstract

Corporate strategies have been increasingly confronted with the need to measure and manage corporate reputation. Despite the importance associated with measuring and assessing reputational risk, the effectiveness of techniques that accomplish these tasks have not kept pace – perhaps due to a lack of a universally accepted definitions or inadequate tools. This paper proposes a reputational measurement matrix to measure and assess reputational risk nationally and internationally for the purposes of closing the current reputational assessment gap. The matrix comprises four key aspects ('who', 'where', 'what' and 'how'): each assesses the degree of risk posed to reputation. Each of the aspects of the four-point matrix will be evaluated via a template termed a 'reputational heat map'. The objective is to examine the numerous factors that influence a bank's reputational risk. A retail bank, used to determine the effectiveness of the implementation, was found to exhibit a high-quality jurisdiction with elevated levels of international compliance. From the 'who' and 'where' perspective, no clear evidence of reputational risk was indicated; for the 'what' and 'how', minimum reputational risk was detected. A suggestion is made to invest in IT systems to strengthen financial institutions' knowledge of their clients.

Keywords

Corporate reputation, reputational measurement matrix, reputational risk, KYC, retail bank.

***Dr E Swanepoel** is a lecturer in the School of Economic and Management Sciences, North-West University, Vanderbijlpark, South Africa. [20429258@nwu.ac.za]

***Dr J Esterhuysen** is a research fellow in the School of Economic and Management Sciences, North-West University, Potchefstroom, South Africa.

+**Prof G van Vuuren** is an extraordinary professor in the School of Economic and Management Sciences North-West University, Potchefstroom, South Africa.

****Prof R Lotriet** is a professor in the School of Business and Governance, North-West University, Potchefstroom, South Africa.

1. INTRODUCTION

The most valuable asset in the capitalist economy is not cash, stock or buildings, but trust (Harrison, 2008). This was the case when banks competed with each other to disperse their un-backed notes among an ill-protected public (Barth, 2009). It is even more the case today, with large volumes of assets churning through international financial markets faster than legal confirmation can be provided. Thus, although a shortage of cash can bring a company to its knees, it is more frequently a loss of reputation that deals the final blow (Economist Intelligence Unit, 2005).

If trust is present in stakeholder relationships and if it is reciprocated, it can be an important driver of improved company performance. It is based on a set of collectively held beliefs with reference to a company's ability and willingness to satisfy the interests of various stakeholders (Dowling, 2006 and Helm, 2007) and should thus be viewed as a stakeholder's evaluation of a company over time, as a socially shared impression, or a consensus regarding a firm's behaviour in any given situation (Dubinsky, 2008). Corporate reputation affects the way in which various stakeholders behave towards an organisation, which can influence employee retention, consumer satisfaction and consumer loyalty (Chun, 2005).

A good reputation encourages shareholders to invest in a company, attracts and retains talent, limits personnel turnover and correlates with superior overall returns (Chun, 2005; Helm, 2007 and Sarstedt et al., 2013). However, business reputation grows and strengthens only as a reflection of the company's relations with key stakeholders. A poor reputation signals that disaster lurks, and that when it strikes, those companies will be incapable of weathering the storm (Conference Board, 2007). Once reputation is compromised, the process of rebuilding it may be costly and lengthy and in worst-case scenarios, reputational capital (a function of benefits gained and costs avoided) may never be recovered. The maintenance or increase of reputational capital is apparent from the increase in productivity provided through better leveraging of stakeholder relationships (Young & Hasler, 2010 and Lizarzaburu, 2014).

Since reputation and managing reputation are essential, reputational risk has emerged as a significant issue in corporate studies (e.g. Power et al., 2009). This increase in significance can, in part, be attributed to an increase in competition, the development of global media or communication channels as a disseminator of reputationally-sensitive information and customer power and their readiness to switch suppliers (Economist Intelligence Unit, 2005). Even as the importance of reputational risk management continues to increase, most companies do an inadequate job of managing their reputations in general and the risks to their reputations in particular. They tend to focus on handling the threats to their reputations that have already surfaced. This is not risk management; it is crisis management – a reactive approach whose purpose is to limit damage (Eccles et al., 2007). It is curious, then, that while tools and techniques proliferate for managing monetary risks, the art of protecting reputations is poorly developed and understood.

Reputation is a primary asset of most organisations, yet reputational risks have increased since the credit crisis (2007/9), possibly because it is harder to manage than other risks. Protecting and maintaining a good reputation it is one of the risk manager's most difficult tasks (Economist Intelligence Unit, 2005). Given the importance of reputational risk, a comprehensive definition emphasises the difficult task facing managers in their attempt to mitigate it. Lizarzaburu (2014) defines reputational risk as the possibility of loss or decline in the reputation of an organisation

in a way that adversely affects the perception that the social environment has on it, and to be an effect of direct or indirect loss in the value of a company.

This work introduces a reputational risk assessment technique comprising four key points, each forming the basis against which reputational risk can be assessed both locally and internationally. The key matrix co-ordinates (who/where/what/how) together form a reputational 'assessment tool kit'.

This risk assessment technique can be used in any institution, but financial institutions provide the focus in this work principally because of the R20bn fine imposed on six major international banks (Bank of America, Royal Bank of Scotland, HSBC, Citibank, JP Morgan and UBS) for rigging foreign exchange rates just two years after they were caught rigging the world's most important interest rate, LIBOR (Damon & Grey, 2014). Financial institutions' reputation and the management thereof not only impact the vast majority of individuals, but also because so much damage has already been done (Treanor, 2014a). A good reputation can increase customer confidence in products or advertising claims, and increase customer commitment, satisfaction and loyalty. It is not surprising that maintaining and increasing corporate reputation has become a crucial management objective for globally operating firms (Sarstedt et al., 2013). A reputational assessment technique such as the one proposed here should enable a company to be proactive and adequately track (and thereby improve) its reputation.

This work proceeds as follows: section 2 provides a literature study detailing previous work covering reputation risk, while section 3 outlines the qualitative assessment of reputation risk. Section 4 details the methodology employed in the assembly of the matrix and section 5 presents and discusses the results obtained. Section 6 concludes.

2. LITERATURE REVIEW

Corporates are constantly confronted with the need to measure and manage corporate reputation (Cravens & Oliver, 2006 and Sarstedt et al., 2013). Since 2000, a rapid growth of evaluative and standard-setting organisations – representing a new space of transnational governance – have developed programmes to construct instruments and metrics for reputation that were developed by employing factor analysis techniques (Power et al., 2009).

Reputation is increasingly being considered an organisational asset, which, therefore, can be managed just like any other organisational asset. Reputation as an asset has increased in significance for companies as sustenance for their competitive advantage: specific corporate characteristics afford them a powerful distinction from their competitors (Sarstedt et al., 2013 and Casado et al., 2014). Management of a company's reputation and reputational risk should be part of an effective risk management strategy and process. The activities and the communication policy of a business gives rise to reputation, and can be a daunting and challenging task.

Reputational risk management is the management of factors that are a source of reputation because reputation is, to a large extent, a perception which forms outside of the company (Lizarzaburu, 2014; Okur & Arslan, 2014 and Van den Bogeard & Aerts, 2014).

Reputation is intangible and by definition vague and abstract, difficult to evaluate directly (Vargas-Hernandez, 2013 and Koutsoukis & Roukanas, 2014).

Although managing reputational risk proves to be demanding, Loh (2007) opines that the key to the effective management of reputational risk is to recognise that reputation is a matter of

perception. Since reputation is perception, it is perception that must be managed (Okur & Arslan, 2014 and Van den Bogeaard & Aerts, 2014). Reputational oversight should reach beyond what management does to enhance the perception of the firm and create reputational wealth. Given the risks that such an intangible asset is exposed to, the Board of Directors should consider performing a corporate reputational risk management oversight function (Razaee, 2007).

This argues for the assessment of reputation in multiple areas, in ways that are contextual, objective, and, if possible, quantitative. The company must evaluate its ability to meet the performance expectations of stakeholders objectively: gauging the organisation's true character is complex. The Chief Executive Officer cannot take sole responsibility nor delegate the responsibility of managing reputational risk to any one individual (Eccles et al., 2007). Organisations need more than just a Chief Reputational Officer to coordinate external affairs, communication and public relations. It is necessary to establish a set of processes to encompass the wide array of business risks the corporation is exposed to and to fully comprehend the manner in which they affect the firms' public perception. These processes should aim to control any potential damage to the corporations' image, not only by means of a communication strategy, but also through a satisfactory response to any business risks which originate from reputational failure (Atkins et al., 2006 and Conference Board, 2007).

Confusion relating to an exact definition adds to the confusion over measurement methods in the reputational literature (Vargas-Hernandez, 2013 and Koutsoukis & Roukanas, 2014). However, a number of measurement approaches are available which reflect the number of possible strategies towards measuring corporate reputation (Klewes & Wreschniok, 2009). Even so, among the measurement scales used to compare firms, many have been criticised as being overly focused on the financial performance of companies, for using a single, uni-dimensional measurement item or being over-focused on the view of a single stakeholder (Chun, 2005).

Reputation risk is understood as a strategy resource and a complex construct and it poses measurement challenges both to those who aim to manage it and those who wish to study it. The understanding and identification of reputational risk is significant: it cannot be assessed nor identified if it is not wholly understood. Organisations are often embedded in media-friendly external measures such as rankings and ratings, and their reputation poses distinctive management issues (Power et al., 2009).

A way to assess reputational risk is by assessing its outcomes, directly, by looking at organisational perceptions in the various shareholder groups (Koutsoukis & Roukanas, 2014; Lizarzaburu, 2014; Okur & Arslan, 2014 and Van den Bogeaard & Aerts, 2014). The approach adopted by a firm depends on its background, school of thought or epistemological basis (Chun, 2005).

The measurement and management of reputational risk is complex in nature, so there are numerous different opinions as to the most effective and efficient manner regarding its assessment. Effective assessment techniques are important for researchers who seek to examine its role as an antecedent, criterion, or moderating variable in different contexts. Models used in the past to measure reputational risk include, but are not limited to, ranking measures, reputational quotients, and identity measures.

2.1 Ranking measures

Ranking measures are among the most established measures of reputation and comprise ranking by the media. Included in these media rankings are Fortune's Annual Surveys of CEOs, the Financial Times' Most Respected Companies, Management Today's Most Admired Companies and Asia

Business' Most Admired Companies. Respondents are asked to rate a competitor's reputation in terms of attributes, although there are some differences in terms of the sample frame or items used, the same criticisms of uni-dimensional operationalisation, using a single stakeholder's views and financially focused criteria, are made (Chun, 2005; Sarstedt et al., 2013 and Zhu et al., 2013). In addition, Sarstedt et al. (2013) opine that these measures cannot capture all facets of corporate reputation. A further point of concern is that these measures rely on single items to measure constructs, which respondents likely perceive as heterogeneous.

It is generally held that abstract constructs require the use of multi-item measures, because most constructs, by definition, are too complex to be measured effectively with a single item. In terms of predictive validity, single items perform well: multi-item scales only under specific conditions. Other authors (e.g. Davies et al., 2010) have observed that these measures are subject to a strong financial halo effect (Chun, 2005; Sarstedt et al., 2013 and Zhu et al., 2013).

2.2 The reputational quotient (RQ)

The RQ is a quantitative approach that evokes the personification metaphor for assessing corporate reputation. Among many metaphors, personification makes sense to individuals; it allows them to comprehend a wide variety of experiences with non-human entities in terms of human motivation, characteristics and activities. The RQ uses personality as a measurement tool that can assess a firm's reputation. One advantage of the RQ is that it is validated for the measurement of both image and identity, which allows for any interrelationship of gaps between the two to be measured (Davies et al., 2003; Chun, 2005 and Chun & Davies, 2006).

While researchers (e.g. Davies et al., 2014 and; Karabay, 2014) acknowledge that the RQ is conceptually superior to ranking measures due to the inclusion of the emotional appeal factor, its strong reliance on cognitive elements has been subjected to criticism. Among the criticisms are the scale's overemphasis on rational elements, the lack of a rigorous conceptual definition and the emotional appeal dimensions (Davies et al., 2004; Schwaiger, 2004; Porritt, 2005; Barnett et al., 2006; Schwaiger et al., 2009 and Sarstedt et al., 2013).

2.3 Identity measures

Identity is measured both as it *is* and as it *should be* using quantitative and qualitative techniques, predetermined dimensions and inductive approaches. A few examples include work by Van Rekom (1997), Balmer and Soenen (1999) and Gioia and Thomas (1996). A procedure for measuring identity was introduced by Van Rekom (1997), who interviewed 25 employees as a first step using the laddering technique. Applying this technique is limited to a small sample and the identified characteristics were tested using a questionnaire survey. The results were compared with a semi-structured laddering technique.

Balmer and Soenen (1999) developed the ACID test (Actual, Communicated, Ideal, Desired Identity) of corporate identity management. The qualitative methods used include in-depth interviews, desk research and content analysis to identify 15 corporate image "interfaces". To measure the interface between actual and desired identity, a range of qualitative research techniques such as interviews, observation, history audit and focus groups were recommended.

Gioia and Thomas (1996) explored the relationship between identity and image both from a senior management perspective, using the triangulation method, which adopts both qualitative and quantitative techniques. Initially a case study and in-depth interviews were constructed and nine

factors were identified by theme analysis: region, type, ownership, size, information processing structure, strategy, image, type of identity, and strength of identity. The relationship between the nine factors were examined by a quantitative survey and tested through regression analysis.

This paper proposes the construction of a four-point reputational matrix. This technique focuses on qualitative data from which assessment will be made. This paper aims to provide a conceptual framework based on literature that could be used to measure reputation risk. This matrix may prove to be superior, because focus is placed on individuals, processes, place and type of business, factors which also help make the matrix more comprehensive.

The next section provides a more detailed discussion on the matrix used to assess reputational risk.

3. MEASURING REPUTATIONAL RISK IN A QUALITATIVE MANNER

With regard to the validity and reliability, an audit in terms of Generally Accepted Auditing Standards was not undertaken. The scope of the paper was limited to a review and analysis of the documents and information provided during the course of the investigation. The validity of the documents has not been verified, nor has the authenticity of the relevant records and documents, other than the instances specifically indicated in this paper. The purpose of the reputational risk assessment was to consider and analyse all the available documents, financial records and other relevant information obtained during the assessment.

This section introduces four key elements (who/where/what/how) which collectively form a matrix used to optimally assess reputational risk. Each key point's importance and validity is examined. The current reputational assessment gap that exists is what this research seeks to close by constructing a new manner in which reputational risk can efficiently be assessed.

3.1 The 'Who'

The 'who' element concerns the risk that any counterparty may pose to reputation. Aspects to be considered in assessing the 'who' include client profile, source of wealth, client intent and underlying beneficiary owner (UBO). The objective is to enable a bank to form a reasonable belief that it knows the true identity of each client, and establish, with relative certainty, the type of transactions in which a client is likely to engage. In addition, this enables a bank to determine when transactions are potentially suspicious. Banks are exposed to large numbers of clients, so it is vital that banks have an understanding of the clients whom they bank. Fortunately, there are numerous techniques available today (e.g. Know Your Client - KYC, internet searches and adverse media screening), in order to aid in the identification of these clients. A bank should obtain information, at account opening, that is sufficient to develop an understanding of normal and expected activity for the customer's occupation or business operations. This may be based on account type or customer classification and this information should allow a bank to differentiate between lower-risk and higher-risk clients (Federal Financial Institutions Examination Council, 2010).

Higher-risk clients present increased exposure to a bank's reputational risk. These clients together with the activities and transactions in which they engage should be reviewed exhaustively at account opening and more frequently throughout the term of their relationship with the bank. A bank may determine that a client poses a higher risk because of their business

activities, ownership structure, anticipated or actual volume and types of transactions, which include transactions involved in higher-risk jurisdictions (Federal Financial Institutions Examination Council, 2010; Financial Services Authority, 2011 and LexisNexis, 2011).

When fraud in the financial sector is rampant, the robustness of a bank's on-board processes become significant. Even at industry levels, fraud can damage a bank's reputation, customer loyalty and shareholder confidence (Joyner, 2011; De Smet & Mention, 2011 and Wu & Wan, 2014).

A bank needs to incorporate a risk-based approach for customer acceptance which will enable risk scoring and detection of potentially suspicious transactions. Sufficient information needs to be gathered to assist the bank in appropriately allocating its resources to clients and transactions that present a relatively greater risk of involvement in money laundering or terrorist financing, and where necessary avoid any association with specific customer categories and/or transactions (Mizuho Bank, 2013; Irwin et al., 2014 and Tsingou, 2014).

A recent example, which emphasises the importance of assessing this factor, was the recent US-MENA Private Sector Dialogue held in New York in October 2014, which provided insight into current trends in banking. It was stated that with the onset of new financial regulations banks need to reassess and redefine their businesses. The failure of certain banks to conduct basic due diligence on some of its account holders, assign appropriate risk categories and ignore warnings that monitor systems which are not adequate, were also debated. The violation of KYC norms that exposed banks to fraud risks were also under discussion. Certain banks failed to check and monitor the relationships its corporate customers had with politically exposed people and failed to identify high-risk transactions. Financial crimes have increased the penalties for banks and also affected the reputational risks (Gulf Times, 2014).

The discussion continued to include AML initiatives to be used in order for financial institutions to be successful. The key areas on which to focus include new account opening procedures, sustained customer identification process, customer risk rating, enhanced due diligence and transaction monitoring and reporting (Gulf Times, 2014).

3.2 The 'Where'

Money laundering (ML) and terrorist financing are closely related to the effectiveness of anti-money laundering laws (AML) and the efficient manner in which these laws are enforced. Banks need to assess the prime location in which clients reside as well as trade (Mizuho Bank, 2013; Irwin et al., 2014; Morris, 2014 and Tsingou, 2014). Concerns about offshore tax abuses and the role of tax haven banks in facilitating tax evasion are longstanding.

Offshore tax evasions are of concern not only due to tax fairness and legal compliance issues, but also because lost tax revenues contribute to a country's annual deficit (Bucovetsky, 2014 and Levin, 2014). The financial crisis of 2007–2009 also revealed that tax haven structures and shadow banking entities play a central role in the practice of financial institutions reliant on financial innovation (Palan & Nesverailova, 2013 and Lysandrou & Nesvetailova, 2014).

Roughly half of the global stock of money is routed through offshore financial centres, many of which are considered tax havens (Palan & Nesverailova, 2013). More recently, the global financial crisis of 2007–2009 revealed the scale of the phenomenon of shadow banking (a complex network of financial intermediation) that takes place outside the balance sheets of the regulated banks, and thus remains invisible to the regulatory bodies. Recent estimates place the amount of accumulated wealth registered in offshore havens at approximately \$US21 trillion, or nearly 18%

of aggregate global wealth. The figures for the shadow banking industry were estimated at \$67 trillion at the end of 2011, and, as a result, the G8 and G20 have become increasingly vocal about managing cross-border tax evasion, especially through tax havens (Palan & Nesverailova, 2013; Adrian, 2014; Fiaschi et al., 2014 Levin, 2014 and Lysandrou & Nesvetailova, 2014).

ML is a process that transforms illegal inputs into supposed legitimate outputs and often involves the abuse of financial institutions as instrumentalities. It broadly encompasses a wide range of activities that may be involved in disguising the origin of proceeds of crime. These proceeds thus represent an input to the process and the output is a pool of assets with an aura of legitimacy. The laundering process may involve a series of transactions conducted in both the informal and formal sectors. Any provider of a product or service that can be used to store or transfer value can itself be abused as an instrumentality in the laundering process. This type of ML is commonly associated with the business of the core financial sector, other financial business, business and professions operating with links to financial sectors and other businesses (Dawe, 2013; Almond, 2014; Yeon, 2014 and Tsingou, 2014).

Money Laundering Risk (MLR) has recently been recognised as a serious risk endangering the financial sector and society as a whole, and is drawing increasing attention in recent decades on both regulation and supervision (Jia et al., 2013).

To appropriately apply the risk-based approach recommended in International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation by the Financial Action Task Force on Money Laundering (FATF) and efficiently allocate supervisory resources, national supervisory authorities need to accurately assess the MLR levels of financial institutions. MLR can be affected by many factors, including institution size, internal rules, and management attitude (Jia et al., 2013; Othman & Ameer, 2014 and Tsingou, 2014).

Recent (2014) news of HSBC Holdings (HSBA)'s Swiss private banking unit being charged by Belgian prosecutors for illegally assisting wealthy clients in the country avoid hundreds of millions of euros in taxes, emphasises the importance of the 'where' aspect. The Brussels prosecutors' office said the bank was suspected of "serious and organised" fraud, money laundering, criminal organisation and acting as an illegal financial intermediary. More than 1 000 Belgian taxpayers could be affected over amounts involving several billions of dollars that were invested, managed and/or transferred between 2003 and 2014 (White, 2014).

Ideally, a bank should be situated in a country with high economic strength, political stability and low levels of secrecy. If the quality of jurisdiction as a financial centre is high together with international compliance, the location of the bank would not pose a threat to the bank's reputational risk.

3.3 The 'What'

The ethical obligations of the sellers of financial products are currently a matter of intense public debate and lobbying (Angel & McCabe, 2012; Bowie, 2013; Sternberg, 2013 and Ferrell & Freadrich, 2014). Investment advice is planning the allocation of the wealth of the client in various financial products. This includes advice relating to the purchase, sell or deal of investment products and advice on an investment portfolio of various assets like stocks, bonds, cash, mutual funds or other investment products. Investment advice can be written or oral or through other means of communication which can benefit the client in the long run. The investment advisory problem can be recognised as decision-making under uncertainty, including the understanding of personal

attributes of the client and the allocation of suitable assets to the client's portfolio (Angel & McCabe, 2012; Mitchell & Smetters, 2013 and Ghosh & Mahanti, 2014).

Catchphrases (in the language used in the banking products' sales) foment a positive outcome despite the fact that there is no safeguard guarantee of clients' money. In addition, financial institutions are aware of the legal liability that accompanies their claims, as is evidenced by the lengthy paragraphs of fine print at the bottom of their web pages and printed materials (Bordt, 2014). In many instances, customers are treated legally according to the fine print in their account terms and conditions, but if they are dissatisfied, this may be due to either miscommunication or misunderstanding of these rules (Malinconico et al., 2013).

An example which emphasises the importance of the 'what' was the recent admission by Barclays that £5bn in Payment Protection Insurance (PPI) was mis-sold by the bank. Although Barclays was not the only bank involved, it made provision for the largest PPI compensation. Other banks include Royal Bank of Scotland (£3.3bn) and HSBC (£2.5bn) (Scuffham, 2014).

3.4 The 'How'

Greed, self-interest or profit maximisation all contribute to an increase in ethical misconduct. Sometimes greed becomes a fever of accumulation for gaining profit. When a client is paying for the service, he/she has full right of loyalty and transparency from the institution, but bankers recommend those investment plans to the client that maximise profits.

Service providers can be in close proximity to the client, which consequently can lead to a conflict of interest. Clients should be treated equitably, and service dealing should not be based on favouritism or the financial position of the client. To fulfil the assigned target or to get recognition, officials often engage in practices to mislead the customer (Bowie, 2013; Sternberg, 2013; Ferrell & Freadrich, 2014 and Mittal et al., 2014).

Participants in the banking sector should adopt best practice and comply with rules. Any illegal or unethical activity should also be discouraged. There should be independence, and the service provider should not be biased by personal relationship, beliefs of other forms of compensation. Risk and reward should be placed accurately so that the client can make a prudent decision and the bank and client's secrecy should not be compromised for personal gain (Mittal et al., 2014).

Another current (2014) example which emphasises the importance of the 'how' is the six major banks (JPMorgan Chase, Citigroup, Bank of America, UBS, Royal Bank of Scotland and HSBC) who agreed to pay more than \$4 billion in fines to international financial regulators for manipulating the multitrillion-dollar foreign exchange market. The six banks agreed to pay a total of \$4.3 billion to the US Commodity Futures Trading Commission (CFTC), the US Office of the Comptroller of the Currency, the British Financial Conduct Authority (FCA), and the Swiss financial regulator FINMA. The extent of manipulation is considerable: the foreign exchange market accounts for \$5.3 trillion in transactions every day—more than 20 times the size of the global stock and bond markets. The total amount of the fines is nearly as large as the earlier LIBOR settlements, in which major banks paid over \$6 billion (Treanor, 2014b).

4. METHODOLOGY

Each of the aspects of the four-point matrix will be evaluated via a template termed a 'reputational heat map'. Each of the four points has different aspects and criteria linked to it.

From the data gathered, each aspect is assessed and rated as either having a high, medium or low impact on a bank's reputation. Each aspect will have a focus area followed by the assessment and findings thereof. The objective of this study is to examine the numerous factors that influence a bank's reputational risk. In doing so, all available documents, financial records and other relevant information obtained were analysed and a report was prepared based on the findings.

The data was obtained from a retail bank in South Africa to perform a reputational risk assessment with reference to the clients that it services, the intermediaries it utilises (the 'who') and the jurisdiction of Mauritius in which it operates (the 'where'). The references also include the products which they sell (the 'what') and the manner in which they do so (the 'how').

The assessment of the 'who', the 'what', and the 'how' was conducted on a South African bank; however, because the South African bank uses Mauritius as a booking or trading centre, only the 'where' applies to Mauritius. The underlying reason for the assessment of Mauritius is due to it being a common tax haven for many companies and it is considered a high-quality jurisdiction, with high levels of international compliance. The Mauritius branch was contacted and asked to complete two templates, which provided information on the customer base profile and included generic questions regarding the source of wealth of the customer base. All relevant risk assessment information was utilised; however, there is a possibility that not all documentation was made available.

4.1 Template 'who'

The template used to assess the 'who' aspect of the matrix consists of four categories to be assessed under control deficiencies. These four aspects include know your client (KYC) (controversial clients due to personal or professional activities clients), source of wealth (source of wealth is controversial – gambling – or related to criminal activities – corruption – or non-transparent), client intent (aggressive tax avoidance, hiding inappropriate sources of wealth or assets from rightful claimants), and ultimate beneficial owner (UBO) (non-transparent beneficiaries of assets i.e. anti-money laundering and sanctions).

De Smet and Mention (2011) argue that because financial institutions' solvency and reputation can be impacted by the aforementioned aspects, all four of these aspects are interlinked. For example, if the depositor's money is stolen it will forfeit its value on the balance sheet and harm the reputation and integrity of the bank. The complementary aspects of know your client and AML are considered to be the most important regulatory area within the private banking industry, and clients do not want their bank to be directly involved in money laundering schemes. Doing so could damage the reputation of the bank. In general the attention given to AML practices has increased due to two assumptions: money laundering is a serious crime and the incidence of laundering must be lowered through concrete international instruments. Once all four aspects have been assessed by each business unit, which of the four aspects poses a risk to the banks' reputation may be determined (Reuter & Truman, 2005; Geiger & Wuensch, 2007 and Alldridge, 2008).

TABLES 1 through 4 are only the templates for the collected and analysed data. The actual data is depicted in TABLES 5 through 8. TABLE 9 concludes the four point matrix. TABLES 1, 3 and 4 are used to assess the four aspects that are rated on a five-point scale. 1 indicates a low risk. 2 – low to medium risk, 3 – medium risk, 4 – medium to high risk, and 5 – high risk. TABLE 2 used the inverse five-point scale, where five indicated low risk and one indicated high risk.

The in-scope business clusters were requested to complete two templates, providing information on the customer base profile and generic questions around the source of wealth of the customer base.

TABLE 1: Template of ‘who’ assessment of reputational risk

| | Control deficiencies | | | |
|-----------------|-------------------------|-------------------------|----------------------|----------------------------------|
| | <i>Know your client</i> | <i>Source of wealth</i> | <i>Client intent</i> | <i>Ultimate beneficial owner</i> |
| Business Unit 1 | | | | |
| Business Unit 2 | | | | |
| Business Unit 3 | | | | |

Source: Authors' analysis

4.2 Template ‘where’

The template which determines the ‘where’ aspect of the reputational risk assessment consists of seven individual factors, each to be assessed (for the purposes of this study) to determine the possible risk it may pose to the bank’s reputation. The specific purpose of each important target segment of the jurisdiction needs to be considered in addition to the financial centre and tax. The strategic relevance to the said bank as well as public perception, financial strength, relevance, and ease of doing business need to be taken into consideration in order to determine which aspect of ‘where’ can be identified as a threat to the bank. Indices and previously conducted analysis of the retail bank were used as a measure. With regard to quality and compliance, 10 separate factors (see section 5.2) were assessed. TABLE 2 uses a five-point scale, where 5 indicates low risk, 4 – medium risk, 3 – medium risk, 2 – medium to high risk and 1 – high risk.

TABLE 2: Template of ‘where’ assessment of reputational risk

| | <i>Differentiating proposition</i> | <i>As a jurisdiction to clients in Africa</i> |
|------------------------|------------------------------------|---|
| Location | | |
| Tax | | |
| Operational costs | | |
| Quality | | |
| Regulatory compliance | | |
| Track record | | |
| Ease of doing business | | |

Source: Authors' analysis

A detailed questionnaire was used to conduct a question and answer session with the retail bank in Mauritius. Workshops with business representatives of the retail bank in Mauritius were conducted. In addition, the bank was asked to complete two templates, providing information on

the customer base profile and generic questions around the country specifically. The completed templates make up the majority of our Where report. Furthermore, searches were conducted of publicly available information and indexes.

4.3 Template ‘what’

The ‘what’ aspect includes assessing whether or not the bank sells appropriate products. This can further be subdivided into two categories which will need to be assessed: these include the social purpose of the products and the nature of the products. With regard to the social purpose, aspects to be considered will include the commercial purpose of the product and the suitability of the product given the client’s risk profile. There are two aspects to be assessed regarding the nature of the product: whether or not the product is within the bank’s recommendation capability and whether or not the product is in line with regulatory expectations.

The findings upon which potential areas of risk were identified are documented. Each focus area is ultimately assigned a risk level (1 – low risk; 2 – low to medium risk, 3 – medium risk, 4 – medium to high risk and 5 – high risk).

Based on the findings and potential areas of risk each focus area was evaluated on a three-point scale to ultimately determine the risk level. If the potential area of risk proved to be of very little to no threat to reputational risk it received a value of one. If the potential area of risk proved to be of medium risk or there was some room for improvement it received a value of two out of three. Finally, if the potential area of risk proved to be high or detrimental to reputational risk, it received a value of 3.

The in-scope business clusters were requested to complete two templates, providing information on the customer base profile and generic questions around the products.

TABLE 3: Template of ‘what’ assessment of reputational risk

| <i>Focus area</i> | <i>Findings/ Assessment</i> | <i>Potential risk area</i> | <i>Risk level</i> |
|--|---------------------------------|--------------------------------|-----------------------|
| Products | | | |
| Suitability of products given client's risk profile, objectives, mandate and level of sophistication | | | |
| Products and services in line with regulators' expectations | | | |
| Are products and services within the bank's capability to appropriately recommend, monitor and manage? | | | |
| Commercial purpose of products and services | | | |

Source: Authors' analysis

4.4 Template ‘how’

The ‘how’ aspect is concerned with the assessment of the manner in which products and services are being delivered. This can further be subdivided into two important categories, which will assess the business practices and the systems and tools. In the assessment of business practice

aspects, pricing incentives and the sustainability of these practices were taken into consideration. With regard to the assessment of systems and tools two important factors were analysed: reporting procedures and determining if the Management and Insurance (MI) practices to manage risks are copacetic.

The in-scope business clusters were requested to complete two templates, providing information on the customer base profile and generic questions around the practices.

TABLE 4: Template of ‘how’ assessment of reputational risk

| <i>Focus area</i> | <i>Findings/ Assessment</i> | <i>Potential risk area</i> | <i>Risk level</i> |
|---|---------------------------------|--------------------------------|-----------------------|
| Engage in business practices that ensure sustainability from the perspective of all stakeholders | | | |
| Align interests between clients, bank, colleagues (e.g. through pricing and performance measures) | | | |
| Provide transparent, clear, accurate, and timely reporting (internal and external) | | | |
| MI that is inadequate to manage risks appropriately and in a timely manner | | | |

Source: Authors' analysis

5. RESULTS

5.1 Reputational Risk Assessment: Mauritius – Summary of ‘Who’ reputational risk indicators

TABLE 5: Data depicted in template ‘who’

| | <i>Control deficiencies</i> | | | |
|---------------------------------------|-----------------------------|-------------------------|----------------------|----------------------------------|
| | <i>Know your client</i> | <i>Source of wealth</i> | <i>Client intent</i> | <i>Ultimate beneficial owner</i> |
| Wealth | 1 | 5 | 5 | 5 |
| Investment management | 5 | 1 | 5 | 5 |
| Insurance and financial advisors | 5 | 1 | 5 | 1 |
| Stockbrokers | 5 | 1 | 1 | 5 |
| Fund managers | 1 | 1 | 5 | 1 |
| Asset management and personal clients | 1 | 1 | 5 | 1 |

Source: Authors' analysis

In TABLE 5 the scores indicate which particular business unit views which control deficiencies as a potential reputational risk, i.e. the wealth business unit indicated that it views source of wealth, client intent and Ultimate Business Owner (UBO) as a highly risky potential source of reputational risk.

Furthermore, it was also found that each of the business units has customers to be considered a high-risk entry type. In addition, the wealth business unit indicated that it banks customers with potentially high-risk sources of wealth. As such all of the business units were found to have a high risk impact on reputational risk.

5.1.1 Know your client

The Mauritius branch completed a template on the profile of their customer base (yes, no, maybe) and separate templates termed "private clients" and "customer profile". Three different sectors were assessed: corporate, private and retail banking.

The completed templates indicated that Mauritius has one foreign national politically exposed person (PEP) as a primary customer. Mauritius also has an unidentified number of PEPs as related parties and Ultimate Beneficial Owners (UBOs), which include foreign PEPs, and it does not have individuals as primary customers, but as related parties and UBOs, which also include foreign nationals.

Mauritius has individual private banking primary customers, related parties and UBOs. Its customer base includes foreign nationals (including South Africans). It has PEPs as primary customers, related parties and UBOs (foreign PEPs, non-South African).

Mauritius has PEPs as primary retail banking customers (by shareholder structure), related parties and UBOs (including foreign PEPs, potentially South African, even though not confirmed). Mauritius also has unlisted companies, both foreign incorporated entities and entities with foreign operations (including South African companies). Mauritius also has foreign and local trusts (potentially South African), pension, retirement and Collective Investment Scheme (CIS) funds, potentially including foreign funds. Mauritius banks companies owned by government (including foreign companies), and charities/clubs/societies/non-governmental organisations, including foreign entities as business banking clients. KYC posed a medium risk to the bank's reputation.

5.1.2 Source of wealth

The management of the branch in Mauritius was provided with a template to complete, in order to identify potential high-risk customer types, from a source of wealth perspective. From the completed template it was assessed that the branch in Mauritius banks companies whose ownership vests in bearer shares, casinos and gambling houses (not internet gambling), highly cash-intensive businesses, arms manufacturer and nominee companies. The Mauritius branch does not provide banking services for clients that are of extreme political or religious groups, nor does it provide banking services to cults or persons/organisations engaged in the incitement of racial hatred. Other excluded clients include those who operate in or are registered in a sanctioned country, customers known to use child labour, customers known to have been involved in terrorism, customers involved in pornography, animal testing/fur trade or shell banks. Source of wealth therefore posed a low risk to the bank's reputation.

5.1.3 Client intent

The data analysed to assess client intent included the data gathered from a retail bank in Africa and was not limited only to the branch in Mauritius. Important aspects assessed included tax avoidance, hiding inappropriate sources of wealth, or hiding any asset from its rightful claimant. The majority of products provided by the retail bank (excluding wealth) are viewed as vanilla products, which involve little structuring and are only offered in South Africa to local residents or international clients who are permanent residents. This in turn limits the risk of these products being used for tax avoidance. In addition, all new products undergo an extensive new product approval process, and if a new product is found to be a potential reputation risk, the product is referred to a reputation risk committee with senior representation for approval. All clients undergo a robust on-boarding process to ensure there are no inappropriate sources of funds, or no assets are hidden from their rightful claimant. Client intent thus posed a high risk to the bank's reputation.

5.1.4 Ultimate beneficial owner

The objective was to identify potential reputational risk areas from an AML and sanctions perspective. The Mauritius branch has one of the most stringent AML frameworks in place within Africa and there are Economic Development Department (EDD) requirements in place for PEP customers within the existing legislation. Sanctions screening was not a local regulatory requirement as at date (2014); however, the Central Bank and the Financial Services Council (FSC) regularly circulate the United Nations Student Association (UNSA) and Al Qaeda lists to all Financial Intelligence (FIs) for implementation and action. All customers and respective related parties are captured on the core banking system and sanctioned screened on a daily basis against existing international and local lists as well as against updates to these lists. The Mauritius branch complies with both the requirements of the specific retail banks' Group PEP policy as well as local legislation, whichever is the most stringent. All staff members are provided with mandatory AML training on an annual basis based on their job description; ad hoc training is also completed on request. Adequate reference material for on-boarding of customers is also available to staff. UBOs posed a medium risk to the bank's reputation.

5.2 Reputational risk assessment: Mauritius – Summary of "Where" reputational risk indicators

The two templates completed by the Mauritius branch in addition to searches of publicly available information and indexes indicated that the Mauritius branch's jurisdiction should be rated as a strategic jurisdiction for all the specific retail banks in Africa. The data also indicated that, other than a transferring pricing issued that is being managed, no evidence of reputational risk exists in Mauritius.

Mauritius is a politically, economically and socially stable jurisdiction. A review of the legal framework and international co-operation indicates that Mauritius is a highly-regulated jurisdiction both locally and internationally.

To obtain the final score of 4.15 (quality) and 4.20 (compliance), 10 factors were analysed and given a rating out of five upon which the average was determined to produce the final score (see FIGURE 1). A score of between 0.00 and 1.90 is an indication of low economic strength, political instability, high secrecy and limited information sharing agreements; a score of between 4.00 and

5.00 is an indication of high economic strength, political stability, low secrecy and full information sharing agreements; a score of between 2.00 and 3.90 is an indication of a midway point between the two extremes. The following factors were analysed:

Quality

- Economic strength driving standards of quality (GDP/capita);
- Access to skills and resources;
- Political stability of jurisdiction (World Bank governance indicators);
- Actual and perceived secrecy (financial secrecy index – tax justice network); and
- Global ranking as a financial centre (global financial centre index).

Compliance

- AML compliance to FATF standards;
- AML compliance to OECD standards;
- Double tax treaty (DTT) status;
- Information sharing status (e.g. TIEA and adoption of automatic exchange "Son of FATCA"); and
- Compliance with FATCA legislation.

TABLE 6: Data depicted in template ‘where’

| <i>Differentiating proposition</i> | <i>As a jurisdiction to clients in Africa</i> |
|------------------------------------|--|
| Location | Excellent location to service clients |
| Tax | World leading tax-efficient county to reside in, Intergovernmental Agreement (IGA) signed for Foreign Account Tax Compliance Act (FATCA) and 14 Deferred Tax Assets (DTAs) signed with countries in Africa but not considered the main reason for international clients to bank in Mauritius. Organisation for Economic and Co-operative Development (OECD) ranks Mauritius as only partially compliant in terms of tax transparency. |
| Operational costs | Relatively low operational costs. |
| Quality | Overall quality as a financial jurisdiction is good and very high for Africa. |
| Regulatory compliance | Overall good (IGA signed Dec 2013). Strict South African exchange control creates arbitrage opportunity for Mauritius to offer banking to International Corporates in Africa. |
| Track record | Across many indices ranked 1 st in Africa, often ranked 2 nd next to RSA and Botswana. |
| Ease of doing business | 1 st in Africa. |

| <i>Differentiating proposition</i> | <i>As a jurisdiction to clients in Africa</i> |
|------------------------------------|--|
| Average | Good jurisdiction with moderate to high credit risk rating. Often used due to preferential exchange control and highly regarded as a risk mitigating jurisdiction. |
| Average score | Quality 4.15 and Compliance 4.2. |

Source: Authors' analysis

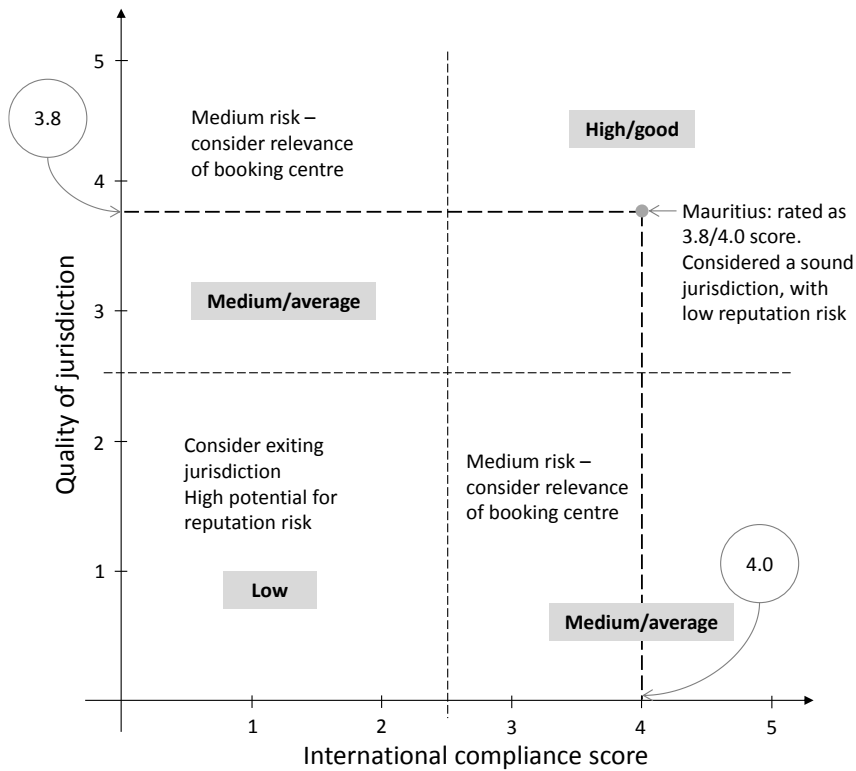


FIGURE 1: External jurisdiction assessment.

Source: Authors' analysis

5.3 Reputational risk assessment: Mauritius – Summary of "What" Reputational Risk Indicators

The research conducted on the 'what' element placed focus on service delivery, more specifically the products. The specific aspects that were assessed included the suitability of the products relative to clients' risk profile; whether or not the products are in line with regulators' expectations; whether the products are too advanced for the bank to provide advice on and the commercial purpose of the products. These aspects were individually assessed, and all the

aspects except the suitability of the products relative to clients' risk profile, which received a medium-risk rating, received a low-risk rating.

TABLE 7: Data depicted in template 'what'

| <i>Area</i> | <i>Findings/assessment</i> | <i>Potential area of risk</i> | <i>Risk level</i> |
|--|---|--|-------------------|
| Products | Asset products (Lending) Liability products (Deposits) Bancassurance e-channels Specific products are offered for the on-shore and offshore markets | None identified – all tax structure and complex trusts terminated | 1 |
| Suitability of products given client's risk profile, objectives, mandate and level of sophistication. | All products follow the New Product Approval Process to ensure they are appropriate for the market A financial need analysis is carried out to ensure all products are in line with risk profile and understanding of the customer In Treasury (for plain vanilla products) the RMs perform necessary screenings and suitability tests as well as credit assessment | Inherent risks in offshore international banking, managed through regulatory framework and management processes. | 2 |
| Products and services in line with regulators expectations. | The NPA Process engages all the relevant departments thus ensuring the input of all functions and risk mitigation on new products The regulator is informed of any changes. Bank of Mauritius regulates all products and services | None identified. | 1 |
| Are products and services within the bank's capability to appropriately recommend, monitor and manage? | Simple vanilla banking products which are easy to manage and monitor Offshore Corporate lending products and Treasury are managed out of Corporate and Investment Banking (CIB). Domestic lending is managed in-country. | None identified. | 1 |
| Commercial purpose of products and services | No tax evidence or structuring undertaken. Trusts are not allowed to be structured. | None identified. | 1 |

Source: Authors' analysis

5.4 Reputational risk assessment: Mauritius – Summary of ‘How’ reputational risk indicators

The ‘how’ aspect was assessed by means of sustainable delivery, assessed by four categories. These categories included business practices that ensure sustainability; the alignment between the clients, the bank and colleagues; the provision of transparent, clear, accurate, and timely reporting both internally and externally; and Management and Insurance (MI) that is inadequate to manage risks appropriately and in a timely manner. Upon the review of the data, sustainable business practices and MI received a rating of medium risk, while alignment and reporting received a low-risk rating.

TABLE 8: Data depicted in template ‘how’

| <i>Focus area</i> | <i>Findings/assessment</i> | <i>Potential area of risk</i> | <i>Risk level</i> |
|---|--|--|-------------------|
| Engage in business practices that ensure sustainability from the perspective of all stakeholders | Engage in business practices that ensure sustainability from the perspective of all stakeholders | Rigorous KYC process. KYC aligned with Know your customer anti money laundering (KAML) policy KYC process is thorough NPA process takes into account the treating customers fairly (TCF) principles Introducer policy has been approved by Business Introducer Committee (BIC) at Regional Level and Group Introducer Committee (GIC) at Group level in line with Group Introducer Policy | 2 |
| Align interests between clients, bank, colleagues (e.g. through pricing and performance measures) | Align interests between clients, bank, colleagues | Introducers are used for new businesses, but are government regulated. Local management companies provide administrative services are remunerated by the client. All introducers have signed a service level agreement (SLA) with the bank, which contains all banking charges (ABC) clauses; as is the practice in the local market, no referral fees are paid by the bank to introducers. | 1 |
| Provide transparent, clear, accurate, and timely reporting (internal and external) | Provide transparent, clear, accurate, and timely reporting | Pricing is strongly regulated and reviewed by the Financial Services Commission (FSC). There is no fee paid to introducers by BBM. Onshore and offshore clients have different pricing structures. | 1 |

| <i>Focus area</i> | <i>Findings/assessment</i> | <i>Potential area of risk</i> | <i>Risk level</i> |
|--|--|--|-------------------|
| | | Tariff guides are available on website and branches for residents. All terms and conditions are also within facility letters a copy of which is provided to the client. | |
| MI that is inadequate to manage risks appropriately and in a timely manner | MI that is inadequate to manage risks appropriately and in a timely manner | Compliance-related MI can be improved as the extraction of UBO Directors' positions on multiple companies is not available. | 2 |

Source: Authors' analysis

TABLE 9: Four-point reputational risk matrix

| <i>Reputational risk level</i> | <i>Findings</i> | <i>Risk rating</i> | <i>Overall risk rating</i> |
|--------------------------------|------------------|--------------------|----------------------------|
| Who | KYC | Medium risk | 3 |
| | Source of wealth | Low risk | |
| | Client intent | High risk | |
| | UBO | Medium risk | |
| Where | Quality | 4.15 | 1 |
| | Compliance | 4.2 | |
| What | Products | Low risk | 1.4 |
| | Suitability | Low / Medium risk | |
| | Expectations | Low risk | |
| | Capabilities | Low risk | |
| | Purpose | Low / Medium risk | |
| How | Sustainability | Low / Medium risk | 1.5 |
| | Interests | Low risk | |
| | Reporting | Low risk | |
| | MI | Low / Medium risk | |

Source: Authors' analysis

6. INTERPRETATION OF RESULTS

Each of the four aspects (who/where/what/how) was evaluated separately based on predefined sub-categories and possible level of risk posed to reputational risk. Each aspect had its own scale or level of importance. The 'who' aspect proved to be the most significant. After the analysis a risk

level was provided which indicated whether said factor was of high, medium, or low risk. For the purposes of this study a retail bank was used in order to test the hypothesis; however, any type of financial organisation, nationally or internationally, can utilise this matrix to measure its reputational risk or aspects which might pose a threat to its reputation.

From this study it was observed that the retail bank had a high-quality jurisdiction, with high levels of international compliance. Mauritius can also be viewed as a preferred jurisdiction due to risk mitigating motivations. The assessment of the 'who', the 'what', and the 'how' was conducted on a South African bank; however, because the South African bank uses Mauritius as a booking or trading centre, only the 'where' applies to Mauritius.

Mauritius (in terms of 'where') has single-borrower limits in Africa, which makes it an attractive jurisdiction. The Mauritius branch also incorporates a rigorous KYC process and conducts internet searches and adverse media screening when on-boarding clients. On the front of the 'who' and the 'where' there is no clear evidence of reputational risk in Mauritius. In addition, there was no evidence of tax structuring or tax evasion, so perceived secrecy appears to be unfounded.

Regarding the 'what' and the 'how' aspects, the assessment indicated that the Mauritius branch sells vanilla products and all tax structuring and complex trusts have been terminated in accordance with local regulation. The Mauritius branch's domestic lending is managed in-country. In addition, there are inherent risks in offshore international banking, but these appear to be well managed through the regulatory framework and strong management processes. In addition, no tax advice or structuring is undertaken and the regulator does not allow banks to structure trusts. Introducers are used for new businesses, but are government regulated, and local management companies provide administrative services and are remunerated by the client. To further their reputational risk, it is proposed that they invest in IT systems to strengthen KYC.

7. CONCLUSION AND RECOMMENDATIONS

Risk profiles and client needs have to be thoroughly explored, and reviewed regularly in line with suitability requirements for providing on-going advice. Stringent controls should be applied to ensure that investment recommendations are unbiased, consistent with the house view, and in line with the client's risk profile / mandate. No unsupported products should be sold or held in advisory and discretionary portfolios without appropriate communication and exception documentation. No personal recommendations should be made to execution-only clients, without exception from (1) tax/ trusts services provided only where there is a genuine commercial purpose (2) are in line with Group Tax Principles, and (3) the client understands the risks. Finally, the retail bank should offer straightforward trust structures with known settlor, predominantly holding 'managed' financial assets with no interest in controversial assets.

As mentioned throughout the paper, reputational risk is of extreme importance and the current reputational gap that exists is what this matrix aimed to close. As the literature and the empirical evidence shows, such a framework is not only comprehensive but is the first of its kind. In addition, the matrix has been tested and has proven to be reliable; however, a limitation of this matrix was the commitment of the test subject, the retail bank.

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