An assessment of reputation- and conduct risks in banking: A four-point approach

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PREFACE

The theoretical and practical work described in this thesis was carried out whilst in the employ of the North-West University under the supervision of Dr Ja'nel Esterhuysen, Professor Gary van Vuuren, and Professor Ronie Lotriet.

These studies represent the work of the author and have not been submitted in any form to another university. Where use was made of the work of others, these have been duly acknowledged in the text.

Article 1, Banking competition and misconduct: how dire economic conditions affect banking behaviour, and Article 2, Dodd-Frank and risk taking: reputation impact in banks, have been published in an accredited international journal. Article 3, Assessing reputational risk: an international four point matrix, has also accepted for publication in an accredited South African journal. All the relevant documentation is attached and forms part of the annexures.

E. Swanepoel

30 September 2016

DEDICATION

To my parents,

Elsin and Nico Swanepoel

"I am thankful to all those who said no, it is because of them I did it myself"

Albert Einstein

REMARKS

The reader is reminded of the following:

This thesis is presented in article format in accordance with the policies of the North-West University's Faculty of Economic- and Business Sciences and consists of three articles (two published, one accepted for publication in 2017).

In the instance of an article from a Ph.D. thesis, the Faculty of Economic- and Business Sciences' Regulation E.9.3 requires that the thesis consists of at least three publishable articles, with a minimum requirement of proof that at least one article has been submitted to a Department of Higher Education approved peer-reviewed journal.

Each of the individual articles comply with the writing style requirements (i.e. the specific abstract, spelling, grammar, and referencing requirements) of the specific journal in which the applicable article has been published.

Articles 1 and 2 have been published, in the international journal, Business Perspectives – Bank and Bank Systems. Acceptance letters attached in annexures at the back of the thesis.

Article 3 has been accepted for publication in the Journal of Economic and Financial Sciences. The acceptance letter attached in an annexure at the end of the thesis.

The author guidelines are included as part of the annexure at the end of the thesis.

The editorial style as well as the references for the rest of the thesis, excluding articles, will follow the format prescribed by the North-West University Referencing Guide (2012). This practise is in line with the policy of the programme in the North-West University School of Business and Governance to use the Harvard Style in all scientific documents.

Language editing documentation is attached as part of the annexures at the back of the thesis.

ACKNOWLEDGEMENTS

I would like to express special appreciation and thanks to my supervisors, Dr Ja'nel Esterhuysen, and Professor Gary van Vuuren. Professor Ronnie Lotriet. Thank you for your encouragement in my research and allowing me to grow as a research scientist. Your advice on my research has been invaluable. In addition, I would also like to thank Elsa Diedericks and Linda Scott for language editing.

A special thanks to my family. Words cannot express how grateful I am to my mother, Elsin, and father, Nico, for all the sacrifices that they have made on my behalf. Thank you for your support and encouragement throughout this experience. To my godmother, Marie Nel, and my aunt, Bets Janeke, who always shower me with love and had faith that I could complete such a herculean task.

To my beloved and most trusted friend, Elandi van Niekerk, I would like to express my utmost gratitude for your support and continual showers of encouraging-, inspirational-, and loving words. In addition, a special thanks to Pat van Niekerk Snr, who always had the most encouraging words to inspire.

The Author

Vanderbijlpark, 2016

ABSTRACT

The primary objective of the study was to evaluate current reputation and conduct practices in the international banking environment in order to construct a four point matrix to be used to measure and manage reputational risk. This was to be supported by secondary objectives, which include, but are not limited to, clarifying of concepts, the examination of misconduct regulation and its impact on reputation. All this was done in article format.

The first article titled "Banking competition and misconduct: how dire economic conditions affect banking behaviour" aimed to demonstrate the manner in which dire economic conditions impacted competition, performance, risk taking and conduct. This was done by detailed analysis on the various financial industry scandals, which include, but are not limited to, the credit crisis (2007/09), the Libor and Euribor scandals, the Payment Protection Insurance scandal and the Foreign Exchange Markets scandal. The literature review was completed with the manner in which competition, misconduct and fines imposed in these banks had been connected. From the literature study, four propositions were formulated, namely (1) Difficult financial times could result in increased competition; (2) Increased competition may result in increased risk taking; (3) Risk taking levels could have an impact on a bank's financial performance; and (4) Decreased financial performance may result in increased misconduct. It was found that dire economic conditions may lead to increased competition, increased competition may lead to increased risk taking, increased risk taking may have an impact on a bank's financial performance and decreased financial performance may lead to increase in misconduct.

The second article titled "Dodd-Frank and risk taking: reputation impact in banks, aimed to demonstrate to what extent the current legislation might have had on the risk taking of six preselected international banks. The legislation analysed included the Glass-Steagall Act, the Gramm-Leach-Bliley Act and the Dodd-Frank Act. The literature review to follow analysed the correlation between risk taking, uncertainty and reputation and led to the formulation of three propositions, namely (1) Current regulatory supervision (Dodd-Frank Act) might not limit risk taking (measured by z-scores) in the banking- and financial industry sectors; (2) Risk taking (measured by z-scores) might have an impact on the market value (measured by share value) of a bank or financial industry; and (3) The market value (measured by share value) of a bank or financial industry might reflect its reputation. It was found that current legislation might have a desired result on risk taking, risk taking might not have an impact on market value and reputation might have an impact on market value.

The third and final article titled “Assessing reputational risk: an international four point matrix”, 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 may be used in any institution, but financial institutions provide the focus in this work, principally because of the R20bn fine imposed on seven major international banks (Bank of America, Royal Bank of Scotland, Morgan Stanley, Citibank, JP Morgan, UBS and Barclays) for rigging foreign exchange rates just two years after they were caught rigging the world’s most important interest rate, Libor.

The matrix comprises four key aspects (who, where, what and how) and each assesses the degree of risk posed to reputation. A retail bank, used to determine the effectiveness of the implementation of the matrix, 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.

Financial institutions’ reputation and the management thereof impacts the vast majority of individuals because so much damage has already been done. A good reputation can increase customer confidence in products or advertising claims, 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. A reputational assessment technique such as the one proposed here should enable a company to be proactive and adequately track (and thereby improve) their reputation.

Keywords: Reputation, competition, misconduct, financial institutions, matrix, Libor.

OPSOMMING

Die primêre doel van die studie was om die huidige reputasie- en gedragspraktyke in die internasionale bankomgewing te evalueer om sodoende ‘n vier punt matriks saam te stel wat gebruik kan word om reputasie risiko te bestuur. Die primêre doelwit is ondersteun deur ‘n sekondêre doelwit, wat insluit maar nie beperk is tot, die uitklaring van konsepte, die ondersoek na wangedrag regulasie, en die impak daarvan op reputasie. Voorgaande was in artikelformaat gedoen.

Die eerste artikel, getiteld “Bankkompetisie en wangedrag: hoe swak ekonomiese toestande bankgedrag affekteer” beoog om te demonstreer in watter mate swak ekonomiese toestande kompetisie en prestasie, die neem van risiko en gedrag beinvloed. Dit was gedoen deur ‘n gedetaileerde analise van die verskillende finansiele industrie skandale, wat insluit maar nie beperk is nie tot die kredietkrisis (2007/09) die Libak en Euribak skandale, die Betalingsbeskermings Assuransie skandaal en die Buitelande Valuta markte skandaal. Die literatuur is voltooi op die manier waarin kompetisie, wangedrag en boetes wat op banke opgelê is, verbind is. Vier voorstelle is geformuleer vanuit hierdie literatuur wat behels: 1) Moeilike finansiële tye kan verhoogde kompetisie tot gevolg hê; 2) Verhoogde kompetisie kan lei tot die neem van meer riskikos; 3) die vlak risikos kan ‘n invloed hê op die bank se finansiële prestasie en; 4) Verlaagde finansiële prestasie kan lei tot ‘n verhoging in wangedrag. Dit is gevind dat swak ekonomiese toestande kan lei tot verhoogde kompetisie, verhoogde kompetisie kan lei tot verhoging in risikos, verhoging in risikos kan ‘n invloed hê op ‘n bank se finansiële prestasie en verlaagde finansiële prestasie kan lei tot ‘n verhoging in wangedrag.

Die tweede artikel getiteld “Dodd-Frank en die neem van risikos: Die impak van reputasie op banke. Is gemik daarop om te demonstreer tot watter mate huidige wetgewing ‘n invloed het op die neem van risikos op ses vooraf geselekteerde banke. Dit was gedoen deur die Glass-Steagall Wet, die Gramm-Leach-Bliley Wet en die Dodd-Frank Wet te analiseer. Die literatuur wat volg analiseer die korrelasie tussen die neem van risiko, onsekerheid, en reputasie. Drie voorstelle is geformuleer uit hierdie literatuur naamlik: 1) Huidige wetgewende toesig (Dodd-Frank Wet) lei dalk nie tot die vermindering in die neem van risikos (gemeet deur “z-telling”) in die bank- en finansiële industrie nie; 2) Die neem van risikos (gemeet deur “z-telling”) mag ‘n invloed hê op die markwaarde (gemeet teen aandeelwaarde) van ‘n bank of finansiële instelling; en 3) Die markwaarde (gemeet teen aandeelwaarde) van ‘n bank of finansiële instelling kan hulle reputasie reflekteer. Dit is gevind dat huidige wetgewing ‘n verwagte resultaat kan hê op die neem van

risiko, die neem van risiko mag dalk nie ‘n invloed hê op die impak van die markwaarde nie, en reputasie mag dalk ‘n invloed hê op die markwaarde.

Die finale artikel, artikel drie getiteld “Assessering van reputasie risiko: ‘n internasionale vier punt matriks”, stel ‘n reputasie risiko assesseringstegniek bekend wat uit vier punte bestaan, elk vorm die basis waarteen reputasie risiko assesseer kan word, nasionaal sowel as internasionaal. Die hoof matrikskoordinate (wie/waar/wat/hoe) vorm gesamentlik ‘n reputasie “assesserings gereedskapskis”. Die risiko assesserings tegniek kan gebruik word in enige instansie, maar finansiële instellings verskaf die fokus in hierdie werk hoofsaaklik as gevolg van die R20 bn boete wat aan sewe hoof internasionale banke (Bank of America, Royal Bank of Scotland, Morgan Stanley, Citibank, JP Morgan, UBS en Barclays) opgelê is vir die sameswering ten opsigte van buitelande valuta slegs twee jaar nadat hulle skuldig bevind is aan sameswering ten opsgite van die wêreld se belangrikste rentekoers, Libak.

Die matriks bestaan uit vier hoof aspekte (wie, waar, wat en hoe), elkeen assesseer die mate van risiko geplaas op reputasie. ‘n Kleinhandelbank wat gebruik is om die effektiwiteit van die implementering te bepaal, het ‘n hoe kwaliteit jurisdiksie vertoon met verhoogde vlakke van international voldoening. Geen duidelike bewys van reputasie risiko kon gevind word ten opsigte van die wie en waar perspektief nie, vir die wat en hoe is minimale reputasie risiko givind. ‘n Voorstel is gemaak dat investeer moet word in inligtingstegnologiesisteme om finansiële instellings se “ken jou kliënt” te versterk.

Finansiële instellings se reputasie en bestuur daarvan beinvloed nie alleen die impak op die grootte meerderheid van individue nie maar ook as gevolg van die skade wat alreeds aangerig is. ‘n Goeie reputasie kan kliënte vertroue in produkte en advertensie, verhoging in kliente verbintenis, tevredenheid en lojaliteit tot gevolg hê. Dit is nie verbasend dat die instandhouding en verhoging in korporatiewe reputasie ‘n kritieke bestuursdoelwit vir firmas wat internasionaal handel geword het nie. ‘n Reputasie assesseringstegniek soos wat voorgetel is behoort ‘n maatskappy in staat te stel om pro-aktief en doeltreffend sy reputasie te volg.

Steutelwoorde: reputasie, kompetisie, wangedrag, finansiële instellings, matriks, boete, Libak

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CHAPTER 1
SCOPE AND RATIONALE OF THE STUDY

1.1. INTRODUCTION

Keywords: Gramm-Leach-Bliley Act; Glass Steagall Act; Great Depression; bailouts; penalties

The Royal Bank of Scotland (RBS) and Barclays Bank (Barclays) are among a raft of global banking giants fined a record £1.4 billion (bn), in 2014, due to illegally formed cartels to rig benchmark interest rates. Eight banks have agreed to penalties with the European Commission (EC) over allegations that they formed cartels to fix two key rates used to set the price of trillions of dollars (US) of financial products from mortgages to complex financial products. The sanctions, the first from the EC on rate manipulation, are the highest to date for European antitrust enforcement (Tomlinson, 2013). Correspondingly, Barclays and RBS have previously been fined following the London Interbank Offer Rate (LIBOR) scandal in which banks conspired to report their interest lending rates fraudulently, either to profit from trades, or to provide a false representation of their creditworthiness (Cervellati, Piras, & Scialanga, 2013). Barclays ultimately was fined £290 million (mn) and RBS fined £391 mn. Furthermore, Lloyds Banking Group has been fined a record £28 mn over incentive schemes that rewarded staff with 'champagne bonuses', which put advisers under pressure to hit sales targets or face demotion. This occurred all in the period from 2012 to 2015 (Russell, 2013).

It can be argued that, at face value, it would seem that no regulations or legislation are in place to either manage conduct risk or limit the damage caused to these banks' reputation that result from such public disclosures. Nevertheless, there are copious amounts of extremely complex banking legislation in the US (e.g. National Banks Act of 1864, the Dodd-Frank Act or the Banking Act of 1933 - sections 16, 20, 21 and 32, and the Volcker Rule). Even so, it is speculated that the legislation in place is not being enforced, is being ignored, or is not designed to protect banks adequately against misconduct (Malloy, 2013). However, the general concern should not be that these banks participate in these activities but the fact that over the years the legislation in place, designed to prevent these banks from misconduct, has faded gradually until legislation was put in place designed to limit the amount of regulation (detailed discussion Chapter 3, Section 2.2, Gramm-Leach-Bliley Act). In addition, it also can be argued that the rigorous competition between banks, the continuous chase for shareholder returns and employees' perceived greed for larger financial compensation, have resulted in reckless banking behaviour. As such, many questions

were raised around the conduct of many large international banks (Malloy, 2013; Goodhart *et al.*, 2013).

Consequently, due to limited regulation, greed and financial compensation, large bank failures could occur. When regulators impose a fine on a bank of a few million dollars (US) when their net worth is over a billion dollars (US), it serves no purpose other than to lessen the burden of other banks also being imposed a fine. A bank can seemingly disregard any regulation put in place and walk away with a warning and an insignificant punishment. The root of the problem is not the actions of the banks, but the legislation in place, which assures liability does not fall upon the wrongdoers.

A further concern is the vast amounts of tax payer money in bailouts, required by American- and European banks, due to aggressive lending and lack of adequate controls. Although these banks, among others, have recently been fined a substantial amount (£1.4 bn in 2014), it is argued that their reckless behaviour is tolerated as a result of limited legislation. Hence, it is only logical to question the regulatory processes, or lack thereof. Robbins (2009) proposes that in order to obtain clarity surrounding the issue of regulation, it is necessary to draw a picture on a canvas wider than that, which at first might seem appropriate to an enterprise of this nature. The onset of the 2009 financial crisis may seem to be from autumn of 1929, however, the causes and conditions originated long before this. In 1914, the outbreak of war in Europe revived the American economy. The war created an international economic situation that aided in the Great Depression (Kindleberger, 1986).

After the First World War, during 1919 and 1920, a short, sharp worldwide economic boom took place, predominantly in Great Britain and the United States (Robbins, 2009). Financial accumulations were let loose on limited stock, which in turn caused prices to soar. This bubble was demand induced with speculation and the expansion of bank credit, which edged it on. The sharp rise in prices eventually led to a sharp decline in prices as production increased and suppliers merged. Nevertheless, prices were still well above what they were in 1914 (Robbins, 2009; Kindleberger, 1986).

Between 1929 and 1933 the United States' GNP declined by 29 percent, prices fell by 25 percent, unemployment reached 25 percent and 11 000 banks either suspended operations or merged to stay solvent. In 1934, only a quarter of the banks that existed in 1929 were still in operation. Wheelock (1995) argues that the cause of the depression was due to the closure of the vast number of banks, which in turn caused the supply of money to reduce interest rates and lending activity and, hence, economic activity declined.

Much of the research on the causes of the depression has a macro-economic orientation with little emphasis on the role of regulations. However, Wheelock (1995) states that government policies influenced bank failures during the depression, which caused differences in the banking market structure across states. In response to the bank failures of the depression, new restrictions on the activities of banks were enacted. The depression was, in part, a function of market structure and government banking policies and regulations.

Phillips (2012) supports Wheelock by proposing that in the nineteenth and twentieth centuries, bankers and brokers often were indistinguishable. In the Great Depression, after 1929, the United States (US) Congress examined the mixing of the commercial- and investment banking industries that occurred in the 1920s. Conflicts of interest and fraud were revealed in some institutions' activities. A barrier to the mix of these activities was set up by the Glass-Steagall Act, which was passed on June 16, 1933. The Glass-Steagall Act or Banking Act of 1933 - sections 16, 20, 21 and 32, separated commercial- and investment banking as well as created the Federal Deposit Insurance Corporation (FDIC), which insured depositor's assets in the event of a bank's default (Berkin *et al.*, 2012).

Stowell (2013) explains that before the Glass-Steagall Act, underwriting-, investment- and depository banking activities were not separated. A bank could take deposits from checking account holders and use that money to invest in securities it was underwriting for its own in-house activities. The safety of depositor's assets was in doubt. The Glass-Steagall Act was a response to this unstable environment (Francia & Hutchinson, 2014; Zhao & He, 2014).

After the Glass-Steagall Act was passed, private banks were no longer able to accept deposits and perform the functions of an investment bank in the US. The Glass-Steagall Act required banks to be either a private- or investment bank. Commercial banks' underwriting capacity was limited severely and these banks were required to reduce their investment banking activities (Zhao & He, 2014; Stowell, 2013).

The overriding reason for this separation of investment- and commercial banks is essential because as investment banks are already "too big to fail" the merger of these entities will pose major systemic risk, which not only can lead to an economic depression but also have the consequence of losing depositors' money. It is folly to allow a commercial bank to be in a position where high risk activities of investment banking can cause insolvency (Zhao & He, 2014). Thus, investment banks should be left to their own creative devices and be subjected essentially only to market forces. However, even though the collapse of Lehman Brothers in 2009 caused the credit crisis (2007/9), the consequences could have been much greater had there been a merger with any

commercial bank. This leaves a much more limited and practicable but essential role for bank supervision and regulation. This should ensure that the commercial banking system is sound and adequately capitalised (Lawson, 2009).

During the 50 years after the enactment of the Glass-Steagall Act and before it was repealed, bank failures were rare. Hence, it can be argued that the Glass-Steagall Act, among others, has been successful in its quest to stabilise the economy and restore confidence. As such, it would be irrational to repeal such an Act (Filson & Olfati, 2014). However, it is evident that the Glass-Steagall Act provided more advantages to the depositors than to the banks (detailed description in Chapter 3, Section 2.1, Glass Steagall Act); hence, it was inevitable that the Glass-Steagall Act eventually would be repealed and in 1999 that is exactly what happened (Zhao & He, 2014). With the enactment of the Gramm-Leach-Bliley Act of 1999 (GLBA), the Glass-Steagall Act was repealed. This new Act allowed banks, securities brokers, investment banks and insurance companies to enter each other's industry segments again. The GLBA removed the restrictions imposed by the Glass-Steagall Act (Dobeck & Elliott, 2007; Zhao & He, 2014).

White (2010) proposes that at the time of the enactment of the GLBA it was hailed by supporters as an important step forward in the removal of the legal barrier between commercial- and investment banking in the United States (Filson & Olfati, 2014). However, a decade later (2009), in the wake of the worst financial crisis since the early 1930s, followed by the worst economic recession since the early 1980s, the GLBA has been flailed by critics as a major cause of the financial crisis (2007/9) (Francia & Hutchinson, 2014). These critics called for a revival of the Glass-Steagall barriers that the GLBA eliminated. The importance to implement the Glass-Steagall Act, or similar legislation, is essential since the acquisition of wealth has become much more important than reputation (Zhao & He, 2014; Lawson, 2009).

Conversely, Francia and Hutchinson (2014) argue that the GLBA did not contribute to the financial crisis (2007/9) and that the Act in place at the time is irrelevant. Even so, for the purpose of this study, the cause of the financial crisis will not be elaborated on. However, it is evident that there has been a change in conduct post the financial crisis (2007/9) (Zhao & He, 2014; Tregenna, 2009). As mentioned, this change can be contributed, to increased competition, continuous desire to maintain large profits experienced before the financial crisis (2007/9) and the continuous chase for shareholder returns and market share (White, 2010).

Perhaps current US banking regulations are experiencing numerous problems, the most significant being non-compliance. In spite of this, the regulation of the banking environment is undoubtedly one of the most important functions in modern markets, specifically since the acquisition of wealth

has taken precedence over reputation (Francia & Hutchinson, 2014). In addition, a cyclical downturn associated with the collapse of the banking system, by an order of magnitude, is worse than a normal cyclical downturn (Tregenna, 2009). Hence, there needs to be a change in the current banking system as it has become more evident that certain legislation tends to favour banks over depositors. This is evident in the numerous public examples that banks are allowed to take on excessive risk, pocket any profit they can master and should things turn out for the worst, they are left with a fine, which might seem hefty but for banks with assets worth US $ billions it would seem like just an insignificant punishment. It is essential that commercial banking legislation should be put in place to protect depositors. Despite this, Tregenna (2009) and White (2010) argue that current legislation and regulation practices are sound. Still, on contrary, the concern is not on more legislation, but rather on behaviour. For every transgression, another piece of legislation cannot be promulgated.

1.2. PROBLEM STATEMENT

It is evident, from the aforementioned discussion that the current US banking legislation and regulations need to be revised or new legislation needs to be enacted. Current legislation practices is analysed (detailed description in Chapter 3), which will indicate that over the years, the legislation in place, designed to protect the depositors and prevent banks from misconduct, has gradually faded (repeal of Glass-Steagall Act) until new legislation was put in place, designed to limit the amount of regulation (detailed discussion in Chapter 3) (Zhao & He, 2014; Francia & Hutchinson, 2014; Stowell, 2013).

Currently, significant regulations in the US are in place, which govern banks in terms of credit-, market-, operational- and systemic risk. However, regulations specifically designed to govern conduct in banks are still incomplete.

Additionally, it is believed that little to no attention has been given to conduct risk over the last 20 years, with much of the focus being on the traditional banking risk. This creates the possibility that banks were and still are left exposed to conduct risk, as they are not required by any legislation to manage conduct risk.

With the lack of conduct risk management, it is believed that banks have been exposed to much more reputational events in the recent past and are subject to much higher regulatory fines. There seems to be a correlation between the level of conduct risk management and the level of fines in banks. The main view is that this sector is already over-regulated, which leaves the dilemma of measuring behaviour in this respect.

1.3. RESEARCH QUESTIONS

Qualitative- and quantitative research was used in this study and the following research questions are posed to narrow the purpose of study:

- How can reputational- and conduct risk be defined and measured?
- How can legislation be remodelled to ensure good conduct?
- Which of these models or legislation currently exist?
- How effective are/were these models or legislation when they are/were in effect?
- What are the challenges in remodelling such legislation?
- Can a reliable and robust framework be developed to measure and manage reputational- and conduct risk?
- Can new regulation be suggested that would encourage good conduct?
- How did conduct risk increase, in the US and United Kingdom (UK), post the credit crisis (2007/9)?

1.4. PRIMARY OBJECTIVE

The primary objective of the study is to evaluate the effectiveness of current reputation- and conduct risk practices in the international banking environment (in the US) in order to construct a framework to be used to measure and manage reputational risk.

1.5. SECONDARY OBJECTIVES

The secondary objectives of the study include:

- Clarify the concepts of reputational- and conduct risk;
- Clarify the relationship between conduct risk and reputation risk;
- Theoretically examine the current practices in place that regulate misconduct;
- Identify criteria for the measurement and management of reputational risk;
- Construct a measuring instrument from the literature to measure reputational risk;
- Examine current regulation practices and their impact on reputational risk; and
- Recommend a valid and reliable conceptual framework to reconstruct current legislation and regulation practices.

1.6. SCOPE OF THE STUDY

The scope of each of the individual articles is detailed.

The research is based on the current relationship between conduct- and reputational risk. In addition, the research analyses the criteria on the manner in which reputational risk is measured. As this study comprises three articles, each article's scope is detailed. For the first article, the sample used to measure risk taking in banks focuses on the largest and most publicly announced international banks (purposive sample), as they are marked as more important than smaller banks from an economic investment perspective. The sample includes seven large (Bank of America, Royal Bank of Scotland, Citibank, Goldman Sachs, JP Morgan, Morgan Stanley and Barclays) international banks from the UK and the US. The banks selected had the most accessible financial statements, whose financial statements were comparable to the rest and who constantly made headlines. The financial data obtained are publicly available and were analysed from the last 11 years (2000 – 2011). With regard to the sample size, from Figure 1.1 it is evident that, at face value, the sample of seven banks in article 1 might seem small when taking a holistic view of the US banking assets in 2014. However, there were eight banks with a combined asset value share of 50 percent of the total US banking assets. In addition, not only were six of these major banks used in the study, they were also the most publicly announced banks. Further to this, Barclays was used as a bank, which represented the UK, as this bank was also the most publicly announced with total assets in 2014 of £285 billion.

The second article includes a sample of each non-deposit-taking institution supervised by the Fed and each Bank Holding Company with assets of US $50 bn or more, to adhere to the Dodd-Frank Act regulations, only six major US financial institutions are identified. As such, purposive sampling is used. For the purpose of this article, only the banks who have to comply with the Dodd-Frank Act regulations were of importance. The financial data obtained are publicly available and were analysed from the last 10 years (2005 – 2014). Again when analysing Figure 1.1, it is evident that only some of the major banking institutions would have to comply with this law and since this law is only enacted in the US, the sample would be smaller, however, still significant.

For the final article, to test the validity of the framework, a commercial bank in South Africa was used. This commercial bank was used to perform a reputational risk assessment with reference to the clients that they service, the intermediaries they utilise (the who) and the jurisdiction of Mauritius in which they operate (the where). 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 references also include the

products that 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.

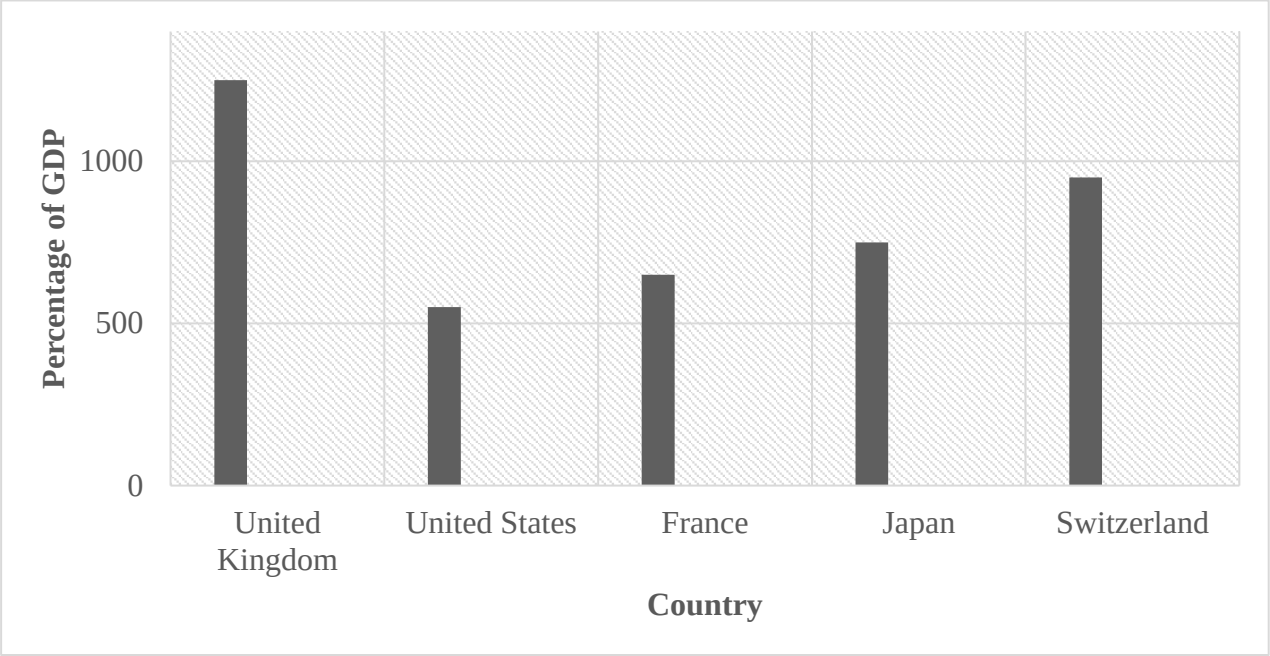
Figure 1.1: Share of US total banking assets (2014)

<table>
<tr><td>J.P Morgan
14.2% of total US banking assets.
Total assets (US $ million): 1,970,450.</td><td colspan="2" rowspan="2">Wells Fargo
10% of total US banking assets.
Total assets (US $ million): 1,388,274.</td><td colspan="2" rowspan="2">Citibank
9.8% of total US banking assets.
Total assets (US $ million): 1,353,237.</td></tr>
<tr><td rowspan="3">Bank of America
10.5% of total US banking assets.
Total assets (US $ million): 1,457,856</td></tr>
<tr><td>Bank of New York Mellon
2.1% of total US banking assets.
Total assets (US $ million): 288,176</td><td>State Street
1.8% of total US banking assets.
Total assets (US $ million): 252,493</td><td>Morgan Stanley
0.8%
US $ 109,364mn</td></tr>
<tr><td colspan="2"></td><td>Goldman Sachs
0.8%
US $ 104,767mn</td></tr>
</table>

(Source: Milken Institute, 2015)

In addition, the UK financial firms hold an average of £20 trillion assets on their balance sheet. This is to be compared with the average income of UK residents of roughly £1 trillion. Further to this, these balance sheets have grown rapidly in recent decades and the UK financial system is larger, relative to the size of the economy, than that of most other countries. From Figure 1.2 it can be argued as to why France, Japan and Switzerland was excluded from the sample and again, it needs to be emphasised that purposive sampling was used, as the US and UK made global news during the said period and, hence, these countries were deemed most important and relevant for the ultimate analyses.

Figure 1.2: The size of the UK financial system compared (2013)



(Source: Milken Institute, 2015)

The proceeding section will detail each of the major banks' (excluding Morgan Stanley, as described in the limitations) vision and strategy to emphasise promises made by these deposit-taking institutions, even though conduct practices made headlines.

Bank of America value statements

In their annual report (2010), Bank of America stipulated that their vision was to be the world's finest financial services company as they think this is an appropriate and achievable goal. Further to this, they state that they have the capabilities in place to meet the core financial needs of their clients more effectively than any other company does. In addition, it was stated that the success in realising this vision will be measured by their customers' continued business, employee turnover and shareholders total returns. Furthermore, as part of their operating principle, Bank of America stated that they are customer-driven, they aim to clean up their legacy issues and they strive to be the best place to work (Bank of America, 2010).

Royal Bank of Scotland value statements

The Royal Bank of Scotland, in their annual report of 2010 (Royal Bank of Scotland, 2010), stated that their overriding focus was to achieve three things which include: (1) to serve their clients; (2) to restore the bank to undoubted standalone strength; and (3) to rebuild sustainable value for all shareholders. Further to this, they made mention specifically of their five-year turnaround strategy

plan implemented in 2009 of which restructuring and restoration of sustainable shareholder value formed the majority. In addition, they mention that leverage, risk concentration and business stretch was being fixed. They also made mention that they would pay particular attention the business culture, which created a balance sheet that could not stand the credit crisis (2007/9).

Citibank value statements

In Citibank's annual report of 2010 (Citi, 2010) they stipulated their mission statement and principles. This statement details their tireless effort to serve individuals, communities, institutions and nations. They continue with emphasis on their efforts to strive to create the best outcomes for their clients with financial solutions that are creative and responsible. Further to this, they highlight four key principles, which include: (1) their purpose – serving their clients; (2) responsible finance – transparent, prudent and dependable conduct; (3) ingenuity – the enhancement to their clients' lives through innovation; and (4) leadership – talented individuals who thrive in a diverse meritocracy that demands excellence.

Goldman Sachs value statements

In Goldman Sachs' annual report of 2010 (Goldman Sachs, 2010) it is stipulated that among others, integrity and honesty are at the heart of their business as they expect employees to maintain high ethical standards in every endeavour. Further to this, in the letter to their shareholders, it is mentioned that strong, healthy financial institutions form a critical part of economic growth and innovation and that they were ready to support this economic activity.

JP Morgan value statements

In JP Morgan's annual report of 2010 (JP Morgan Chase and Co, 2010) Jamie Dimon, the then Chief Executive Officer (CEO) concluded with this letter to shareholders stating that JP Morgan had 70 projects and work teams, all in place to assure regulatory changes. In addition, he ensures that they will meet all the new rules and requirements, both in letter and in spirit and ensure that all their operations are done with the client foremost in mind. However, as the letter to shareholders continues, it is mentioned continuously that JP Morgan's management team and Board of Directors (BoD) were completely focussed on all the opportunities the market provided. Furthermore, it is also mentioned that banks need to take on risk in order to gain profit to keep being competitive. Moreover, they continuously mention that the prices of their products are likely to increase as a result of new regulation. Jamie Dimon's letter to shareholders concludes with his utmost satisfaction of his employees on the extraordinary jobs they have done in difficult financial times.

Barclay's value statements

In Barclay's annual report of 2010 (Barclays, 2010) specific reference was made to the execution of their strategy. The points made include, but are not limited to, risk management and financial discipline. The statement continues with an explanation of the importance of risk management and their knowledge and understanding of the risks their clients undertake. In addition, it is mentioned explicitly that they understand in order to execute their strategy it is essential they ensure that they retain financial discipline required to deliver returns.

1.7. RESEARCH DESIGN AND METHODOLOGY

Robson and McCartan (2016) propose that the process of scientific research involves several stages. Using scientific methods and procedures in each of these stages, knowledge is required, which explains the mystery of certain phenomena. Scientific knowledge has three core features that include systematic observation, control and replication. The research methodologies allow for exploration of unexplained phenomena. Using methods and techniques that are scientifically defendable, conclusions can be drawn, which are valid and reliable. Quantitative research uses structured methods to evaluate objective data. Qualitative- and quantitative research methods are performed in this study. The research approach followed seven steps, which include:

Identify the research topic: It would seem that the manner in which banks conduct themselves has changed post the credit crisis (2007/9), which might be attributed, in part, to increased competition. As such, the underlying factor, which surrounds the purpose of this study, is the analysis of the numerous factors that contributed to this evident change in conduct, with focus on the US and the UK. In addition, the current legislation in place in the US and UK is analysed based on criteria, which determine its validity and sufficiency.

Literature review: A critical review of the literature, which directly focuses on the research topic, is crucial. An advanced literature review is used as the basis for providing the background statements and the argument for the research study. For the purpose of this study, the resources investigated included journal articles, electronic sources, textbooks, financial statements and experts in the field of risk management. These resources indicate if there is in fact a change in the manner in which banks conduct themselves post the credit crisis (2007/9) and if the current legislation in place is adequate.

Theoretical formation of the research problem: This study aims to create a framework for banks, which can support the measurement and management of reputational risk. Also included is an

analysis on the link between reputational- and conduct risk. Once a link has been established, the major changes in conduct risk and, hence, reputational risk post the credit crisis (2007/9) is studied. Once the results of the changes have been documented and the possible rationale behind the phenomena established, suggestions as to possible improvements will be provided.

Research design: methods and procedure: The research design followed is to collect and ensure validity and reliability of data and to ensure the documentation of unbiased data. The results obtained from the design will shed light on the research problem. Changes in conduct risk post the credit crisis (2007/9) will be analysed. Changes in fines received pre the credit crisis (2007/9) in comparison with the amount of fines received by banks post the credit crisis (2007/9) will be used as a factor to determine the manner in which conduct has shifted. Factors that contributed to the change in conduct will be analysed at length. Risk taking pre- and post the credit crisis (2007/09) will be measured by means of correlation of the ROE on z-scores and ROA on z-scores (detailed discussion in Chapter 2 and 3). Profitability is measured by means of ROE and ROA; hence, they will be used as a basis. Stability is measured by z-scores $z=(ROA+CAR)/\sigma(ROA)$. One important and relevant study conducted by Chiaramonte, Croci and Poli (2015), confirmed that the z-score was still very relevant and could even be compared to CAMELS (capital, asset quality, management earnings, liquidity and sensitivity to market risk) variables. This particular study focused on the empirical attractiveness of the z-score, as it does not require strong assumptions about the distribution of ROA. In addition, Chiaramonte *et al.*, (2015), examined whether the z-score was an accurate tool to predict bank distress on a sample of banks from 12 European countries.This method is also used in chapters 2 and 3 (articles 1 and 2).

Current US legislation practices (detailed description in Chapter 2, Section 2.3, Dodd-Frank Act) is investigated to conclude whether or not improvement is needed. Conduct risk is compared to other types of risk to determine the manner in which the most important risks are being managed and measured. The reputational effect of the Dodd-Frank Act (to be limited to the US) is measured by means of correlations of share value to z-scores and net income on z-scores. As mentioned, the reason for this measure is the accuracy with which the z-score improved with respect to the study completed by Chiaramonte *et al.* (2015).

Finally, a framework to be designed will enable the measurement and management of reputational risk and will comprise questions such as who (client intent), where (structure of tax evasion), what (product complexity) and how (sales tactics). Each question will carry a weigh of importance to be determined by their importance and validity. Once the framework has been designed, it will be tested in practice to ensure practicality and reliability. The current reputational assessment gap that

exists is what this research seeks to close by constructing a new manner in which reputational risk can be assessed efficiently.

Chapter 4 uses two different rating scales, both Likert scales, with the four aspects rated on a five-point scale, where one indicates a low risk, two a low to medium risk, three a medium risk, four a medium to high risk and five a high risk. The second scale uses the inverse five-point scale where five indicates low risk and one indicates high risk.

Data collection: Data are collected from reputable sources in order to construct and measure the validity of the framework to measure and manage reputational risk. In order to analyse the change in conduct risk post the credit crisis (2007/9), in some instances, data is sourced from the market, *inter alia* the collection of the information from deposit-taking institutions (Chapter 4, Article 3). The same procedure is followed in the analysis of the limitations in current legislation, which relate to the focus of the specific banks in the US (Chapter 2, Article 1).

Data analysis and interpretation of results: After the necessary data have been collected, the results will be analysed and interpreted. The framework as well as the changes in conduct risk will be tested and verified using the Statistical Package for the Social Sciences (IBM SPSS Statistics 22) and Microsoft Excel add-in PHStat version 4.

Conclusion: Having analysed the data, the results will be reported in article-style reports for peer review and publication.

1.8. LIMITATIONS OF THE STUDY

Due to mergers of certain banks and the timeline of the study, some deposit-taking institutions (Wells Fargo and Lehman Brothers) had to be excluded from the study sample, as their annual reports were either not available or their balance sheet changed too significantly. In addition, as mentioned, only the most published deposit-taking institutions were chosen, this further limited the sample, as some (Bank of New York Mellon and State Street) were not included. For Morgan Stanley, only their 10-K was publicly available, with limited to no information on their values, mission and strategy available. This limited the sample of the study significantly, in addition only the US and the UK were used in articles 1 and 2, whereas only one South African commercial bank was used to test the validity of the framework in Article 3. It is also important to note, that due to anonymity, no specific names were be used in Article 3.

1.9. SIGNIFICANCE OF THE STUDY

From the aforementioned discussion, it is evident that as banks compete for the same profits and market share, which has now declined, current conduct practices have changed dramatically post the credit crisis (2007/9). These changes have raised questions regarding current US legislation and regulations being enforced. The study investigates the current change in conduct after the credit crisis (2007/9) in the US. The study analyses factors, which contribute to the changes experienced in conduct and contribute by gathering data from the US market, which is compared and reported. This analysis attests to the fact that conduct risk has either increased or decreased post the credit crisis (2007/9).

Moreover, an analysis on the current significance and sufficiency of legislation in the US is conducted (Chapter 3, Article 2). This is done by means of correlation of z-score to determine if the objectives of the current Act (Dodd-Frank Act) are being achieved (detailed analysis in Chapter 3, Article 2). This analysis will either prove or disprove that current legislation practices are sufficient, upon which suggestions will be provided.

In addition, 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 framework co-ordinates (who/where/what/how) together form a reputational 'assessment tool kit'. These four key points 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.

This risk assessment technique may be used in any institution, but financial institutions provide the focus in this work, principally because of the R20bn fine imposed on seven major international banks (Bank of America, Royal Bank of Scotland, Citibank, Goldman Sachs, JP Morgan, Morgan Stanley and Barclays) for rigging foreign exchange rates just two years after they were caught rigging the world's most important interest rate, Libor.

1.10. CHAPTER LAYOUT

Based on the vast amount of banking legislation and the detailed and complex manner in which banks are regulated, this study analyses, among others, the current misconduct practices, which include the Libor and Payment Protection Insurance (PPI) scandal. This study outlines the importance of measuring reputational risk as well as explaining the relation between reputational-

and conduct risk. It includes an analysis on the current practices followed and makes suggestions to improve. Each chapter is presented in article format.

Chapter 1: Scope and rationale of the study

Chapter 2, Article 1, Banking competition and misconduct: how dire economic conditions affect banking behaviour, discusses, among others, the latest (between 2012 and 2015) PPI-, Libor-, Euribor- and Forex scandals. These scandals provide evidence that conduct- and reputational risk are interrelated. An analysis on the numerous other misconduct practices is included, which includes the manner in which clients were mis-informed, being sold products, which were not suited for them and that management was knowledgeable and failed to take action. The chapter elaborates further on the issue of misconduct and explains the fundamental factors that contributed to the Libor scandal, which saw banks fix interest rates for years without any intervention or regulatory action. Focus also is placed on certain practices, which include 'champagne bonuses' and the 'a grand in your hand' for hitting targets. The essence of this chapter pertains to the manner in which conduct risk changed post the credit crisis (2007/9). Due to high profits enjoyed before the credit crisis (2007/9), employees were put under pressure to maintain the same level of profits after the crisis struck; however, with increased competition, among others, this became a challenging task, which saw a change in conduct. The underlying reasons for the changes in conduct are analysed. To validate the findings of change in conduct, the correlation between fines imposed on banks is analysed and compared pre- and post the credit crisis (2007/9).

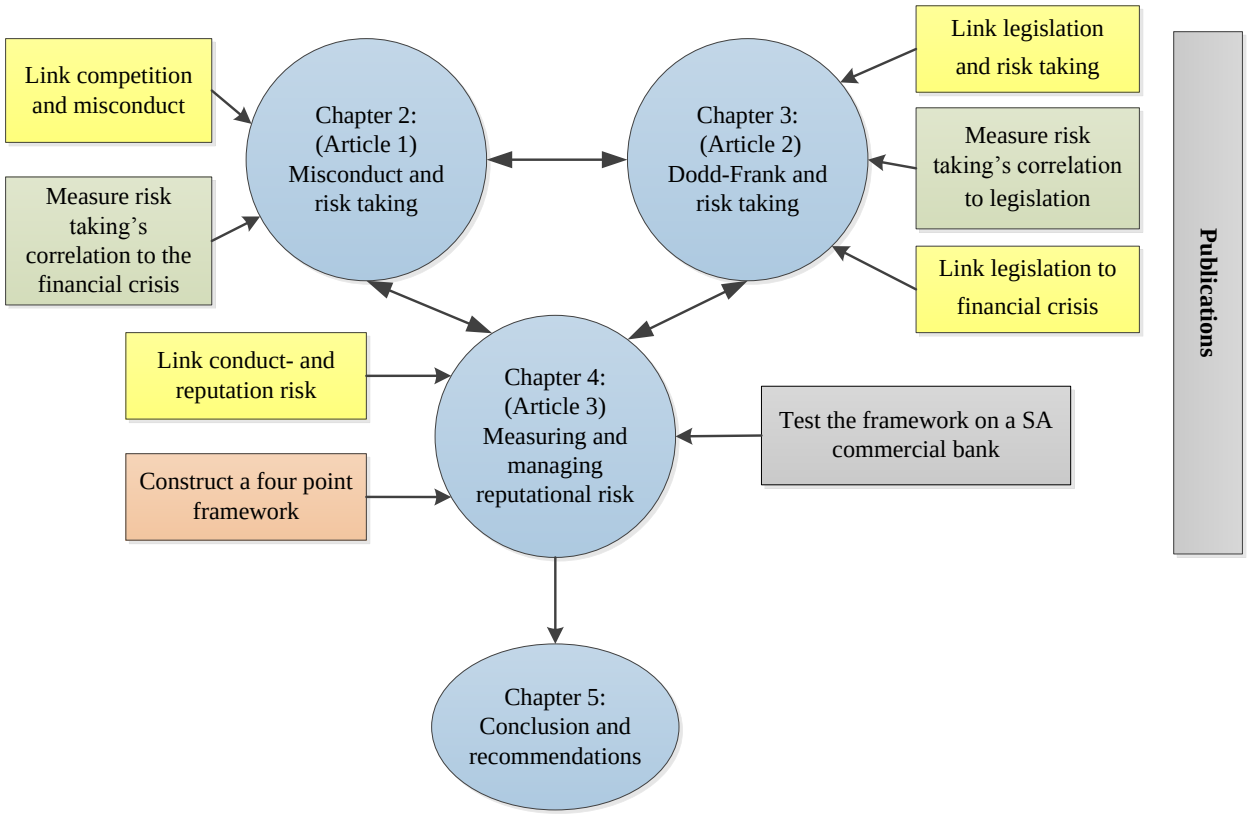
Chapter 3, Article 2, Dodd-Frank and risk taking: reputation impact in banks, commences with the current- legislation and regulation practices in place. An analysis of whether or not the current legislation in the US is sufficient to manage excessive risk taking, which may have a diverse effect on reputation, is the underlying issue of this chapter. Various types of legislation are investigated, which include the Glass-Steagall Act, the Gramm-Leach-Bliley Act and the Dodd-Frank Act. An analysis of z-scores indicates the degree of risk taking. The correlation between risk taking and market value is analysed. The chapter concludes with the analysis of the impact market value has on reputation.

Chapter 4, Article 3, Assessing reputational risk: an international four point matrix, provides a discussion of the measurement and management of reputational risk. The main aim of this chapter is to establish if there is any correlation between reputational- and conduct risk as well as the current manner in which reputational risk is being measured and managed. Also included in the chapter is an analysis on the current manner in which reputational- and conduct risk is understood conceptually and the importance of managing these risks. A framework, thereafter, is constructed

to aid in the manner in which reputational risk can be measured. Each of the components of the framework are provided a weight as well as a motive behind the chosen importance. The framework is tested against data collected from a South African commercial bank.

Chapter 5, Conclusions, recommendations and a proposed reputational risk measurement framework summarises the main findings of the study, draws conclusions and makes recommendations to the study. This chapter provides the main contribution of the study as an integrated whole, which is a framework designed to promote good conduct. The chapter discusses the limitations of the study and presents recommendations, after which it provides some directions for future research.

Figure 1.3: Schematic representation of thesis



1.11. SUMMARY

As detailed, there have been numerous conduct related issues in the US and UK banking environment in recent years. As the primary objective of this thesis is to construct a framework in order to link conduct- to reputation risk, secondary objectives are constructed in order for this framework to be realised. These include, but are not limited to the examination of the conduct practices pre- and post the credit crisis (2007/9) and legislation pre- and post the credit crisis

(2007/9) in order to indicate what might have caused this change in conduct. This thesis is constructed via several articles, each published. The majority of the research is done on the US and the UK, which also limits the scope of the study. Further to this, the framework is tested on one South African commercial bank, to assure reliability and accuracy. The proceeding chapter, Article 1, details the different scandals, in particular the Credit Crisis (2007/9), Libor and Euribor, PPI and Forex. Four propositions are developed from the literature study upon which data analysis is performed to establish validity.

CHAPTER 2

ARTICLE 1

BANKING COMPETITION AND MISCONDUCT: HOW DIRE ECONOMIC CONDITIONS AFFECT BANKING BEHAVIOUR

Ezelda Swanepoel, Ja'nel Esterhuysen, Gary van Vuuren, Ronnie Lotriet[1]

Abstract

Increasingly in the last decade, largely due to perceived greater shareholder pressures for more profitable performance, compensation maximisation has taken centre stage in some segments of the banking industry. Banks need to establish board governance committees with explicit responsibilities to monitor corporate ethics and culture. This paper aims to measure the correlation between dire economic conditions, competition, banking profitability, and misconduct. This is done by means of GDP comparisons to determine economic conditions, calculating z-scores to determine bank risk taking, and analysis of variance of return on assets, return on equity and z-scores, to determine profitability, and fines comparisons to determine misconduct. The statistical package for social sciences was used to perform these analyses. It was found that dire economic conditions may lead to increased competition, increased competition may lead to increased risk taking, increased risk taking may have an impact on a bank's financial performance and, decreased financial performance may lead to increase in misconduct.

Keywords: Dire economic conditions, competition, risk taking, financial performance, misconduct.

JEL Classification: C21, G01, G21, G32.

1. INTRODUCTION

Between 2007 and 2009, world financial markets were in the midst of a credit crisis of historic breadth and depth, which began as a result of consumer defaults on subprime mortgages widely viewed as the worst financial crisis since the Great Depression of 1929 (Ivashina & Scharfstein, 2010).

This credit crisis raised concerns about the solvency and liquidity of financial institutions worldwide with the failures of Lehman Brothers and Washington Mutual, in addition to government takeovers of Fannie Mae, Freddie Mac and AIG, in the largest bank failure in United

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States (US) history. As a result, global credit markets halted and unprecedented government intervention worldwide was required (Duchin *et al.*, 2010; and Erkens *et al.*, 2012).

Furthermore, at the onset of the credit crisis, with the collapse of Lehman Brothers and Washington Mutual, liquidity concerns drew public scrutiny towards the London Interbank Offer Rate (LIBOR). At that time, the perceived default and liquidity risks of banks rose significantly, driving up LIBOR (Brunnermeier, 2009). Hence, the LIBOR rate in January 2008 for one-month LIBOR was set at 3.14%, for three-months was 3.11%, for six months was 3.04%, and for 12 months was 2.85% (BBC News, 2013). However, evidence surfaced as early as 2005 that Barclays, a United Kingdom (UK) based bank, had attempted to manipulate the dollar LIBOR and European Interbank Offer Rate (EURIBOR) rates at the request of its derivative traders (Das, 2012 and; BBC News, 2013). As the collapse of Lehman Brothers and Washington Mutual caused liquidity concerns which increased LIBOR, reflecting the true nature of the health of the banking sector, the manipulation from Barclays was in turn an attempt to distort this reality, claiming the banking sector was in better condition than in actually was.

Consequently, LIBOR has been termed the world's most important number and is the primary benchmark for global short-term interest rates (Abrantes-Mentz & Evans, 2012). As a result, it can be inferred that manipulation of this primary benchmark in a banks' favor could yield extreme benefits. This was the case in June 2012, when the UK and the United States (US) authorities fined Barclays £290 million for manipulating LIBOR and EURIBOR (Das, 2012 and; Eisl *et al.*, 2013).

In addition to the credit crisis (2007/9) and the LIBOR and EURIBOR manipulation, concerns with regard to customer protection as well as banker's behavior have come to prominence in financial regulation in the last decade. From 2005 onwards, when the Financial Services Authority (FSA), assumed their relevant statutory mandate, it has been grappling with the problem of the mis-selling of Payment Protection Insurance (PPI). PPI related uses have also been a major concern for the Financial Ombudsman Service (FOS). During 2011 alone, the industry paid out around £1.9 billion by way of redress to consumers who were mis-sold PPI (Campbell, 2006; and Inderst, 2009). However, the Financial Conduct Authority (FCA) estimates the likely total figure to be in the region of £9 billion (FCA, 2015).

More recently a number of investigations have been launched in the US and UK by regulatory agencies and central banks into the alleged manipulation of the foreign exchange (Forex) market. The Forex market involves daily transactions between financial institutions that accounts for $5.3 trillion (tn) in transactions every day, more than 20 times the size of the global stock- and bond

market (Ryder, 2014). This may have come as a surprise to regulators, as the Forex market has been considered by regulators too big to manipulate hence, it has been largely unregulated (BBC News, 2014; and Ryder, 2014).

The paper contributes to the literature in several ways. It details the different banking scandals which include the LIBOR, EURIBOR, Credit Crisis of (2007/09), PPI- and the Forex Scandals. In addition, it details the relationship between competition, misconduct, and fines imposed in the US and UK banking industry. However the main contribution is the calculated correlation between how difficult financial times lead to increased competition, hence increased risk taking, and thus misconduct in banking. The paper also makes mention of the efficiency of the z-score as a manner in which risk can be measured.

The paper proceeds as follows: Section 2 provides a literature study detailing the different scandals with focus on US and UK banks while Section 3 details the correlation between competition, fines imposed, and misconduct, pre- and post the credit crisis in banking. Section 4 details the methodology used. Section 5 presents and discusses the results obtained. Section 6 concludes and highlights the implications and future direction for research.

2. LITERATURE REVIEW

Increasingly, in the last decade, largely due to perceived greater shareholder pressures for more profitable performance, as well as increased competition to hire talent, compensation maximization has taken center stage in some segments of the banking industry (Rhodes, 2015). Hence, it has become imperative to strengthen the accountability of managers. Therefore, new frameworks are put in place to enhance the accountability of managers for activities that not only relate to credit-, market- and operational risk but also to all aspects of reputational risk. Banks need to establish board governance committees with explicit responsibilities to monitor corporate ethics and culture (Rhodes, 2015).

Much of the commentary and analysis about the actions of financial institutions, from the credit crisis to events such as product mis-selling, the recent LIBOR, EURIBOR and Forex scandals all share a common and fundamental focus - weaknesses in the cultures of banks and other financial institutions. In addition, there is enormous public skepticism that the leaders of banks will take decisive actions that deliver real cultural change. Even so, further misdeeds will assuredly prompt authorities to impose even greater fines and shareholders will not take this lightly (Rhodes, 2015).

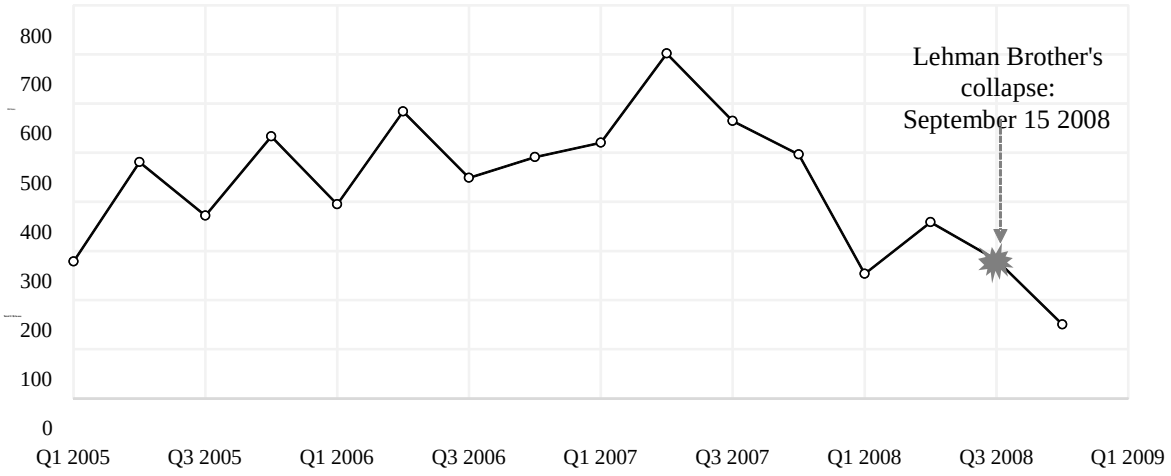
2.1 Credit Crisis (2007/9)

Motivated by the significance of the credit crisis, an emerging body of literature (e.g. Bruner, 2011; Safian, 2011; and Erkens *et al.,* 2012) has identified and examined certain macro-economic factors. These factors formed the roots of the credit crisis and affected all firms however, some more than others. Studies in this regard (e.g. Kirkpatrick, 2009; Aebi *et al.,* 2012; and Erkens *et al.,* 2012) argue that firms' risk management- and financial policies have a significant impact on the degree to which firms were impacted by the credit crisis. As a result, the Organization for Economic Co-operation and Development (OECD) has pinpointed failures in risk management as the most important cause of the credit crisis and has noted that this failure was attributed to weakness in corporate governance more than to defaulting risk assessment or risk models (Brunnermeier, 2009; and Kirkpartic, 2009).

In addition, as a result of the credit crisis, the credit quality of European- and US banks deteriorated substantially. Hence, US financial institutions have seen enormous declines in capital related to write-downs of bad loans and plummeting values of collateral debt obligations (CDOs). These huge losses have resulted in an increased interest in risk management on the part of financial institutions, and have lowered both their capacity and willingness to take on risk. Evidence of tighter lending standards and withdrawn lines of credit abounds (Duchin *et al.,* 2010; and Fukuda, 2012).

Figure 1 graphs the quarterly dollar volume of loan issuances from 2000 through 2008. The decline in new loans accelerated during the banking panic. The dollar volume of bank loans declined from $701bn in the second quarter of 2007, the peak of the credit boom, to $281bn in the third quarter of 2008. Three months later in the third quarter of 2008, it declined even further to $150bn. This decline in loans could lead to competition between banks as shareholders still demand returns (Ivashina & Scharfstien, 2010).

Figure 1: Total US$ Amount of Loans Issued from 2005 to 2008



Source: (Ivashina & Scharfstien, 2010).

2.2 LIBOR and EURIBOR

LIBOR originally reflected rates at which banks in the Euro-dollar market lent surplus liquidity to one other, the interbank rates offered. As the market grew, an accepted pricing benchmark was required. Consequently, the British Bankers Association (BBA) together with major global financial institutions and regulators, primarily the Bank of England (BoE), created the BBA rates. Initially these rates were standard only for interest rate swaps (IRS). An IRS is an agreement in which two counterparties agree to periodically exchange fixed and floating rates of interest over a number of periods of time (Gottesman, 2016). However, demand for a standard benchmark for financial instruments, based on money market rates, led to the creation of the BBA LIBOR fixings. This officially commenced on the 1st of January 1986 (Abrantes-Mentz & Evans, 2012; and Das, 2012).

Since 1986, LIBOR has become integrated into the majority of the world's financial products, and currently provides the reference point for nearly all interest rate derivatives and variable rate loans available in the European financial markets (Abrantes-Mentz & Evans, 2012). LIBOR rates are used as a benchmark to set payments on roughly $800 trillion-worth of financial instruments, which range from complex interest rate derivatives to simple mortgages (Fukuda, 2012; Koblenz *et al.*, 2013). LIBOR is currently calculated for fifteen different loan durations, which range from overnight to a year and in 10 currencies (Abrantes-Mentz & Evans, 2012; and Ryder, 2014).

LIBOR is supposed to measure the rate at which large banks borrow unsecured funds from one another at various short-term maturities, and for a variety of currencies (Ryder, 2014). Moreover, the rate signals a bank's health to financial markets, rising when a bank is in trouble, and creates the basis for payments on trillions of dollars in corporate debt, home mortgages, and financial contracts world-wide. Hence, the impact of even small rate shifts can be critical (Koblenz *et al.,* 2013). Therefore, due to its pervasiveness in, and significance for the financial markets, the rate has come to be known as "the world's most important number". Unfortunately, there is growing evidence that certain banks have manipulated LIBOR both individually and through coordinated behavior (Abrantes-Mentz & Evans, 2012; Koblenz *et al.,* 2013).

In point of fact, by the spring of 2012, US and UK investigators had uncovered substantial (Koblenz *et al.,* 2013) evidence that Barclays and several other banks manipulated LIBOR. Included in this evidence were emails of Barclays derivatives traders who made a total of 257 requests to fix LIBOR and EURIBOR rates (FSA, 2012). In June 2012, following an extensive investigation, Barclays admitted to misconduct. Again, Barclays' unethical LIBOR submissions were to create the impression that the bank's financial position was better than it actually was. In July 2012, the UK's Serious Fraud Office (SFO) launched a criminal investigation into the LIBOR scandal. The SFO investigated a total of eighteen banks which include Citigroup, Inc.; Royal Bank of Scotland; UBS; Lloyds Banking group and Deutsche Bank (Koblenz *et al.,* 2013).

2.3 Payment Protection Insurance (PPI)

A PPI policy provides insurance against a borrower who might become unable to make credit payments for specified reasons (Campbell *et al.,* 2011). This includes accidents, sickness, unemployment and death. As with any other type of insurance, PPI terms may include or impose restrictive conditions on particular types of claimant or claim, and may be subject to other terms and limit the quality of the cover provided (Campbell *et al.,* 2011 ; and Ferran, 2011).

Consumers who may be ignorant to understand complicated financial contracts can become particularly vulnerable to mis-selling by distributors incentivised by remuneration structures to push financial products, irrespective of product suitability for the customer (Campbell, 2006; Inderst, 2009; Campbell *et al.,* 2011; Mullainathan *et al.,* 2012; and Beyer *et al.,* 2013).

As the credit crisis caused an increase in competition and incentives to chase high targets enjoyed before the credit crisis remained, employees were eager and willing to push financial products. In addition, employees were rewarded with certain practices which include "champagne bonuses" and "a grand in your hand" for reaching targets. Accordingly, in December 2011, HSBC was fined

£10.5 million by the FSA and undertook to make redress for the mis-selling of unsuitable asset-backed investment products to fund long-term care costs for elderly customers. In addition, in January 2011, Barclays was fined £7.7 million by the FSA and needed to pay roughly £60 million redress for suitability and related compliance failures in respect of the selling of balanced income and cautious income funds to customers who were mostly retired or nearing retirement (Ferran, 2011; Mullainathan *et al.*, 2012; and Beyer *et al.*, 2013).

2.4 Foreign Exchange Markets (Forex)

Rapidly changing prices in the Forex market make it difficult to establish the going rate for particular currencies at any one time. Therefore, in order to facilitate businesses and investors to value their multi-currency assets and liabilities, cross rates for 10 major currencies are fixed. This is based on actual currency deals that take place in a window 30 seconds before and 30 seconds after 4pm London time. WM Reuters calculates the fix rates based on observed transactions, which form the benchmarks for that day (BBC News, 2014; and Goodway, 2014).

Clients of banks regularly put in orders to buy or sell currencies at the fix rate ahead of it being fixed. A bank with net client orders to buy a currency at the fixed rate will make a profit if the average rate at which it buys the currency in the market is lower than the rate at which it sells to the clients. Banks can legitimately manage their currency book to try and improve the changes of this being the case (BBC News, 2014; and Goodway, 2014).

However, as clients put in orders to buy a currency at the fix rate ahead of it being fixed, most banks saw a golden opportunity to manipulate Forex market since the market is unregulated as it accounts for $5.3tn in transactions each day and was considered too big to manipulate. The enormity of the market accounted for the fines being four times larger than those imposed following the LIBOR scandal. Six banks (JP Morgan Chase, Citigroup, Bank of America, UBS, RBS, and HSBC) have been fined £1.1 billion by the FCA, and £880 million by the Commodity Futures Trading Commission (CFTC) (BBC News, 2014; and Ryder, 2014).

3. COMPETITION, MISCONDUCT, AND FINES IMPOSED

Historically, the banking industry has been exempt from the strict application of a competition policy. Competition was undesirable, given its responsibility for instabilities in the banking systym. However, this perception has been somewhat revised (Hasan & Marinc, 2013).

An efficient financial system allocates resources with as little costs as possible (Hasan & Marinc, 2013). Competition helps achieve this efficiency, particularly cost efficiency. Some studies (e.g. Stiroh & Strahan, 2003; and Evanoff & Ors, 2008) find that competition among banks is good for the industry and the economy. Higher competition positively affects not only the efficiency of the banking industry, but also the productivity of the real economy. Several studies (e.g. Dell'Ariccia & Marquez, 2006; and Boot & Marnic, 2009) also indicate that competition enhances monitoring and consequently, credit allocation (Hasan & Marinc, 2013).

The key issue with the nexus of competition and stability in banking relates to the manner in which competition interferes with banking during bad economic periods when bank failures may have dire repercussions for an entire economy. Stability in banking during bad times is a major concern, and government- or regulatory intervention becomes crucial to prevent bank failures. Therefore, in the face of a financial crisis, competition must not create a situation where long-term damage of the economy results. Therefore, enhanced regulatory- and supervisory frameworks are required to facilitate competition. However, the problem is that the financial industry is already over-regulated (Hasan & Marinc, 2013).

These regulatory and supervisory frameworks were either not in place or not effective enough to mitigate long-term competitive distortions which resulted in banking misconduct, eventually leading to banking failures. In addition, during the credit crisis, bank supervisors lacked tools to restructure failing banks successfully. The fragmented supervisory structure aggravated the problem, and the pressure on financial stability mounted, triggering intervention by national governments, which supported failing banks mainly through a wide framework of state aid. As stated, in times of financial crisis, competition needs to deviate from the standard case scenario and support interventions necessary for the stability of the financial system. However, as a result of either the lack of supervisory competitive frameworks or the absence thereof, misconduct mounted as each bank fought for their fair share in the market (Hasan & Marinc, 2013). In consequence, Proposition (1); (2); (3); and (4) can be formulated:

Proposition (1): Difficult financial times could resulted in increased competition.

Proposition (2): Increased competition may result in increased risk taking.

Proposition (3): Risk taking levels could have an impact on bank's financial performance.

Proposition (4): Decreased financial performance may result in increased misconduct.

4. RESEARCH METHODOLOGY

4.1 Profitability

ROA and ROE is a comprehensive measure of bank profitability (Athanasoglou *et al.,* 2008; Garcia-Harrero *et al.,* 2009; and Tarrif & Majeske, 2013). Both these measures will be used because banks that rely heavily on deposits and borrowings rather than on stakeholders' equity to support assets tend to have higher ROE than those that do not. There are no set benchmarks for ROA and ROE, however, it is evident higher returns indicate greater profitability (Tarrif & Majeske, 2013).

4.2 Stability

Risk taking can be measured by means of z-scores developed by Roy (1952); Hannan and Hanweck (1998); and De Nicolo (2000). The z-score is a measure of bank stability and indicates the distance from insolvency. It combines accounting measures of profitability, leverage, and volatility. Specifically, insolvency can be defined as a state where losses surmount equity ($E > \pi$) where E is equity and π is profit. The probability of insolvency can be expressed as $prob(-ROA < CAR)$ where ROA is return on assets calculated as π/A and CAR is the capital-to-asset ratio calculated as $E/$A. If profits are assumed to follow a normal distribution, it can be shown that z = (ROA+CAR)/SD(ROA) which is the inverse of the probability of insolvency (Brandao-Marques *et al.,* 2013; Mirzaei, 2013). More specifically, the z-score indicates the number of standard deviations that a bank's ROA has to fall below its expected value before equity is depleted and the bank is insolvent (Roy; 1952; Hannan & Hanweck, 1998).

Thus, a smaller z-score can be associated with narrow returns, larger return volatility, or higher leverage (Mirzaei, 2013). Moreover, an increase in the capital-to-asset ratio would raise the z-score, as would an increase in the operating return on assets. A z-score can only be calculated if the accounting information for at least four years is available.

4.2.1 Model Diagnostics

As the z-score has been used extensively throughout literature, the importance and relevance thereof may come into question. In order to prove that this model is still very relevant as well as accurate a study conducted by Chiaramonte, Croci and Poli (2015), who compared CAMELS as a measure of bank risk to the z-score. They used these tools to acquire the empirical attractiveness of the z-score.

They found that the predictive ability of the z-scores held, even when using different computational approach, which took into account the average returns on assets over a three-year period. They also assessed the predictive power of the z-score according to various bank characteristics and found that the z-score was slightly more effective when the organizational and productive complexity of banks increased along with the public incentives to scrutinise bank riskiness, as it is the case for large banks. Lastly, Chiaramonte *et al.,* (2015), maintained that the accuracy of the z-score marginally improved with respect to the whole period during the credit crisis (2007/09).

4.3 Population, Sample, and Data Collection

This study comprise two samples as a fully systematic test of bank risk taking would require data from all international banks affected by the credit crisis and such a study is not feasible. Hence, the sample used to measure risk taking in banks focused on the largest and most publicly announced banks as they are marked as more important than smaller banks from an economic investment perspective. The sample includes seven large international banks from the US and the UK. The financial data obtained are publicly available and were analysed for the last 11 years (2000 to 2010)

Furthermore, the study also analysed the fines imposed on international banks, however, the data obtained comprise the collective amount of large international banks. The data were obtained from the Financial Services Authority (FSA) and the Financial Conduct Authority (FCA). The FSA was the UK's integrated financial regulator however, in 2010 it was stated that the FSA would be abolished and the Bank of England would be put back in charge of supervision. The FCA is responsible for consumer protection in financial services and the regulation of conduct of business, and market regulation, including the listing of securities. The FCA also assumes the responsibility for consumer credit regulation that is currently exercised by the Office of Fair Trading (Ferran, 2011). The fines table from both these authoritative bodies were analysed and the combined fines of all the international banks for each consecutive year were documented in Table 4 and 5.

4.4 Data Analysis

In order to test the propositions different techniques were used. For Proposition (1): a literature review was conducted as this can be evidenced by the significant decline in profits, confidence, and stock markets during the credit crisis. To test for Proposition (2): the z-scores for the individual banks, as well as the mean z-score, were calculated using Microsoft Excel as only basic descriptive statistical analyses were used.

To test for Proposition (3): the Statistical Package for Social Sciences (SPSS), was used to perform more advanced statistical analysis by means of correlation and analysis of variance (ANOVA) of ROA, ROE and z-scores. One of the reasons for the frequency of regression of ANOVA applications is its suitability for many different types of study design. ANOVA procedures are applicable to experimental, quasi-experimental, and non-experimental data.

5. RESULTS AND DISCUSSION

5.1 Descriptive Statistics

Two data sets are provided. The first data set provides the descriptive statistics between 2000 and 2006, as this is the period prior to the credit crisis being officially declared by the National Bureau of Economic Research (1 December 2008). The second data set provides the descriptive statistics between 2007 and 2010 as this is when the credit crisis reached a peak. The reason for the two different timelines is to determine if the credit crisis did in fact cause increased risk taking by the banks.

Table 1 provides the descriptive statistics for the analysed variables for the period between 2000 and 2006, a period which signifies high economic growth, and a period just prior to the financial crisis. The profitability measure of ROE varies between 3.99% and 30.88% with a mean of 16.50% and a standard deviation of 5.47%. Hence, the ROE measures from the various banks differ significantly.

The mean ROA is 0.93%, with a standard deviation of 0.39%. This indicates that 68% of the data lie within the range of 0.54% and 1.32%, again indicating a large dispersion of data. The profitability as measured by ROA varies between 0.23% and 1.64%. The z-scores for the seven international banks vary between 0.83 and 11.04 with a standard deviation of 2.76 and a mean of 5.47. This indicates possible outliers, as the standard deviation indicates that 68% of the data lie within the range of 2.71 and 8.23. This indicates that some banks were outperforming their counterparts.

Table 1: Descriptive Statistics from 2000 – 2006.

	N	Minimum	Maximum	Mean	Std. Deviation
ROE	48	3.99	30.88	16.50	5.47
ROA	48	0.23	1.64	0.93	0.39
z-scores	48	0.83	11.04	5.47	2.76

Table 2 provides the descriptive statistics for the analysed variables between 2007 and 2010. The seven banks' profitability as measured by ROE varies between -28.28% and 29.03%, with a mean of 5.73% and a standard deviation of 11.39%. The large standard deviation indicates the data are to a large extent dispersed from the mean as 68% of the data lie between -5.66% and 17.12%, which indicates some banks were very profitable while others were very unprofitable with regard to ROE.

68% of the profitability of the seven banks, as measured by the ROA, varies between –1.63% and 1.41% during the period and has a standard deviation of 0.64%. The mean ROA is 0.31%. This again indicates that there was a large range of data, hence the banks reported large differences in the values of their ROA. The mean z-score for the seven international banks between 2007 and 2010 is 1.41, with a standard deviation of 1.46, a minimum of -1.71 and a maximum of 4.20. Again, there was a large dispersion of data, as 68% of the data fell within the range of 0.05 and 2.87, which indicates the possibility of outliers. Hence, some banks outperformed their counterparts.

Table 2: Descriptive Statistics from 2007 to 2010.

	N	Minimum	Maximum	Mean	Std. Deviation
ROE	28	-28.28	29.03	5.73	11.39
ROA	28	-1.63	1.41	0.31	0.64
z-scores	28	-1.71	4.21	1.41	1.46

6. PROPOSITION TESTING RESULTS

From the literature study it is evident that difficult financial times resulted in increased competition, since competing bank's fight over the remaining profits left in the market. Furthermore, to support Proposition (1), the database presented by the World Bank (2015) which, among many, indicate the OECD (Organization for Economic Co-operation and Development) member countries' GDP annual percentage growth rates, suggest at the decline in profits. This is depicted in Figure 2. As is evident from Figure 2, there is a decrease in GDP of OECD member

countries of 2.03%. A decrease in the GDP results in a decrease in economic activity, which leads to less banking or lending activity. In such a situation it will result in increased competition to ensure shareholder value. Furthermore, from the financial statements used to calculate the z-score, the mean net income indicated a decline of US$4.7bn or 58.45% in profits, depicted in Figure 3. Thus, the alternative Proposition (1) can be accepted.

Figure 2: OECD member countries' GDP annual percentage growth rates

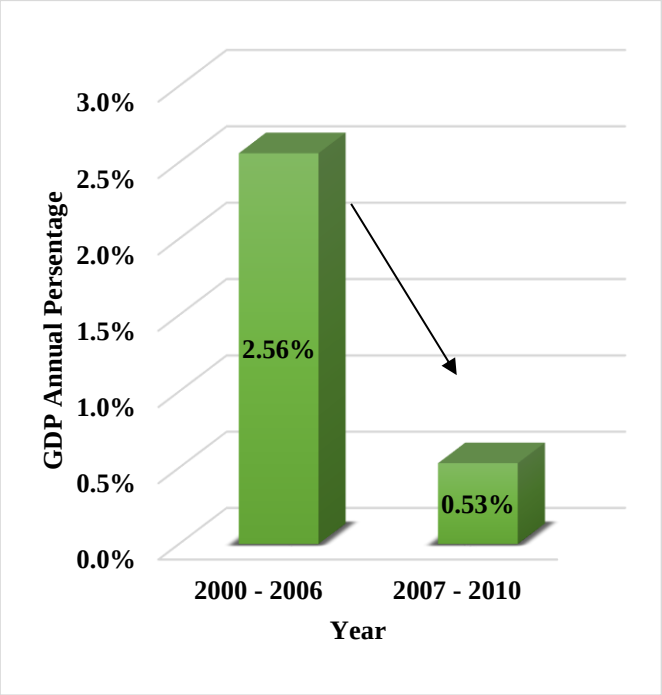
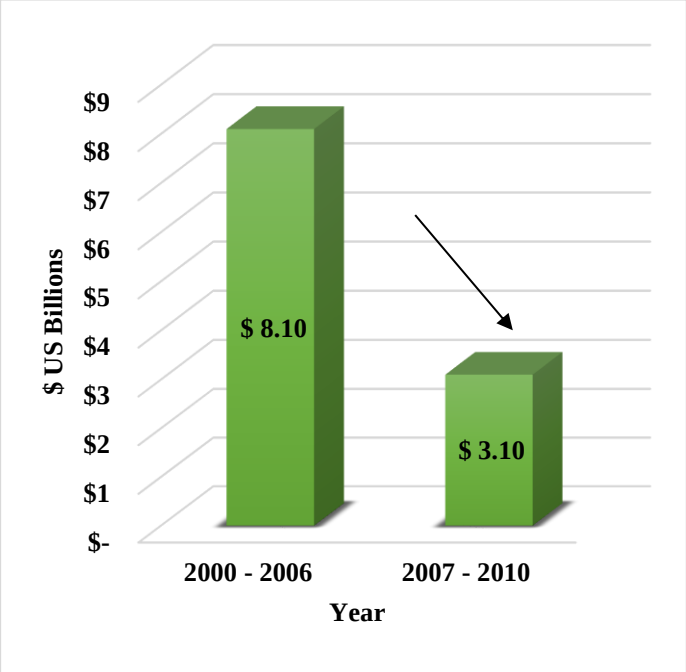


Figure 3: Mean Net Income in US Billions



For Proposition (2) Table 1 and Table 2 provide descriptive statistics for the periods 2000 – 2006 and 2007 – 2010 respectively. From both these tables it is evident that risk taking did in fact increase during the credit crisis as the mean z-scores, which is the measure for risk taking, decreased from 5.47 to 1.41, a decline of 74.22%. Thus, the Proposition (2) can be accepted.

Proposition (3) was tested using inferential statistical tests, which consisted of simple linear regression and ANOVA tests. Table 3 presents the results of regression ROA and ROE on risk taking. The regression analysis tested the relationship between the seven international banks' level of risk taking and average ROA and ROE to determine if risk taking affects financial performance. The data from 2007 to 2010 were used. The results show that the model with ROA and ROE as dependent variables is significant with a sig = 0.00 with an adjusted R Square = 0.655. Furthermore, the coefficient z-scores are positive which indicate that the higher the z-score the higher the ROA and ROE will be.

From the results of Table 3 it can be deducted that the independent variables (ROA and ROE) describe 65.5% of the changes to the dependent variable. Further to this, the Beta values from the Coefficient table are the regression equation ($B_0 = -0.11$; $B_1 = 0.21$; $B_3 = 5.62$). Thus the regression equation can be denoted as $\hat{y} = -0.11 + 0.21 + 5.62$. The Standard Error for the Constant indicates that at an $\alpha = 0.05$ and degrees of freedom (df) of 45, the Beta of -0.11 falls between the range of -1.452 and 1.452. This was calculated with a critical value of 2.021. Taking $\alpha = 0.05$ with df of 45 and a critical value of 2.021 this can be computed for all the variables.

The t value is derived by dividing the Beta with the Standard Error. This value is used to determine if the data are statistically significant. However, the data analysis provided Sig. values and with a Sig value < 0.05 the data are statistically significant. From this it is evident that risk taking is a significant predictor of ROE with a sig = 0.00 however, risk is not a significant predictor of ROA with a sig = 0.692. This would suggest that risk taking levels do have an impact on a bank's financial performance but only, within the limits of this study, on ROE.

Table 3: Regression and ANOVA of ROA and ROE on z-scores.

Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.818[a]	.670	.655	1.62

a. Predictors: (Constant), z-scores

ANOVA (Analysis of Variance)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	240.02	2	120.01	45.64	.000[b]
	Residual	118.32	45	2.63		
	Total	358.35	47			

a. Dependent Variable: z-scores

b. Predictors: (Constant), ROA, ROE

Coefficients[a]

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		β	Std. Error	Beta		
1	(Constant)	-0.11	.773		-0.15	0.885
	ROA	0.21	0.05	0.042	0.4	0.692
	ROE	5.62	0.749	0.793	7.5	0.000

a. Dependent Variable: Z-Scores

Proposition (4): Decreased financial performance resulted in increased misconduct. The data were obtained from the FSA and the FCA on fines imposed from 2002 to 2006 and from 2012 to 2015. Although numerous other authoritative bodies imposed fines, only the data from these two authoritative bodies were used. Table 5 indicates the combined yearly amount (£) for all banks during the periods 2002 to 2006 and 2012 to 2015. The results from Table 5 indicates that from the period 2002 to 2006 the average amount of fines were £17.0 million (mn), where the average amount of fines between 2012 and 2015, a period which signifies dire economic conditions, as experienced by the aftermath of the credit crisis amounts to £891mn. An increase of £874mn, which indicate that dire economic conditions and diminished financial performance, has resulted in increased misconduct. Hence, the alternative Proposition (4) can be accepted.

Table 4: FSA/FCA fines imposed on US and UK banks between 2002 and 2006.

Year	*Amount (£) in millions*
2002	7.4
2003	10.0
2004	24.0
2005	16.0
2006	13.0
Mean	**16.0**

Source: (FSA, 2015; and FCA, 2015).

Table 5: FSA/FCA fines imposed on US and UK between 2012 and 2015.

Year	*Amount (£)in millions*
2012	311
2013	474
2014	1 471
2015	171
Mean	**891**

Source: (FSA, 2015; and FCA, 2015).

7. CONCLUSION

In order to accept Proposition (1) an extensive literature review was conducted. The literature review confirmed that dire economic conditions resulted in increased competition as there were reports of "champagne bonuses" and "a grand in your hand" for reaching targets. Furthermore, as a result of the credit crisis, and hence, declining profits, banks were forced to compete with the changing markets as well as keep their profits high as was experienced prior to the credit crisis.

Proposition (2): was accepted based on the resulting z-scores from seven international banks calculated from 2000 to 2006 and from 2007 to 2010. The mean z-scores decreased from 5.47 to 1.41 in, which indicates increased risk taking. Proposition (3): Risk taking levels had an impact on bank's financial performance, was accepted only on the basis that the ROE was the only factor significantly impacted by the levels of risk taking. Proposition (4): was accepted based on the fines imposed by the FSA and the FCA, based on the presumption that increased fines are a result of

increased misconduct. From the period 2002 to 2006 the mean fines imposed amounted to £16mn and from the period 2007 to 2015 the mean fines amounted to £891mn for an increase of £874mn.

8. IMPLICATIONS AND FUTURE DIRECTION FOR RESEARCH

Misconduct in trading has far-reaching implications for the financial institutions in which this occurs. First, it is costly. Trading losses, fines, settlements, capital provisions, litigation costs, and redress costs together build up to high "cost per case" that undermine business profitability, and deplete capital reserves. Second, there is reputational damage that negatively impacts business trust. The trust of the public, consumers, politicians, companies, in banks is at an ultimate low. Yet, trust is important to secure future sales and funding conditions. Negative consequences of misconduct can also be felt in their legal implications. Court rulings increasingly attend to the accountability of the bank involved, and the senior management overseeing the trader that behaved unethically.

Evidently the "cost" of misconduct is high, however this does not seem to diminish misbehaving, as such, one future direction for research is to analyze possible disciplinary actions against not only CEO's but also senior management.

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CHAPTER 3

ARTICLE 2

DODD-FRANK AND RISK TAKING: REPUTATION IMPACT IN BANKS

Ezelda Swanepoel, Ja'nel Esterhuysen, Gary van Vuuren, Ronnie Lotriet[2]

Abstract

The banking industry plays a significant part in both the financial system and economy as a whole. As of 2012, the US banking system had US $14.45 trillion in assets. However, the importance of the banking system goes beyond its mere size. Numerous studies have shown that the health of this sector has significant effects on overall economic activity, as well as the size and persistence of economic cycles. This paper aims to measure the correlation between current legislation, risk taking, market value, and reputation. This is done by means of calculating z-scores to determine bank risk taking. The z-scores were correlated to market value to determine its impact. Reputable firm behaviour was used to determine the correlation between market value and reputation. The statistical package for social sciences was used to perform these analyses. It was found that current legislation might have a desired result on risk taking, risk taking might not have an impact on market value, and reputation might have an impact on market value.

Keywords: Financial system, risk taking, reputation, market value, legislation.

JEL Classification: C21, G18, G21, G32, G38, K23.

1. INTRODUCTION

The United States (US) economy expanded rapidly since the last financial downturn in 1920, with the inflationary assistance of bankers and the federal government. The prosperity of the 1920s in the US was followed by the Great Depression, which started in 1929. On 3 September and 12 October 1929 respectively, share prices dropped substantially and speculators were sold out as they failed to respond to margin calls (Christianson, 2014). From 1929 to 1933 US Gross National Product (GNP) declined by 29%, the price level fell by 25%, the unemployment rate reached 25%, and approximately 9 000 banks suspended operations because of financial distress (Wheelock, 1995).

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As a result of the exceptional amount of speculation permitted by Wall Street rules, which many believe contributed largely to the economic downturn (Rothbard, 1972), the Glass Steagall Act was passed in 1933 (Lucas Jr & Nicolini, 2014). This Act prohibited National and Federal Reserve member banks and bank holding companies (BHCs) from underwriting corporate equity and debt (White, 2010). The Act was passed as a result of perceived conflicts of interest between banking and underwriting (Calomiris & Haber, 2013).

Advocates of the Glass Steagall Act claim that potential conflicts of interest between commercial and investment banking are too severe and these institutions should remain separate (Cyree, 2000). Bank lobbyists, however, argued that the Glass Steagall Act and the restrictions it imposed, did not improve the banking industry (White, 2010). Notwithstanding, between 1933 and 1937 real GNP in the US grew at an average rate of over eight percent per year and between 1938 and 1941 with over 10% per year. These rates of growth are spectacular, even for an economy pulling out of a severe depression (White, 2010; Crawford, 2011; Wall, 2014).

Nonetheless, after six decades the Act was repealed in 1999 (Cyree, 2000) and the Gramm-Leach-Bliley Act (GLBA) of 1999 was enacted (White, 2010). The most important feature of the new law was the repeal of legal separation of the commercial and investment banking industries (White, 2010; Calomiris & Haber, 2013). Over time, commercial and investment banks, in cooperation with complaint regulators, questioned statutory restrictions in order to find a way in which to combine commercial and investment banking (Wall, 2014).

The GLBA widened the range of activities that banks and their holding companies could conduct, and repealed the parts of the Banking Act of 1933 that separated commercial banking from the securities business (White, 2010; Calomiris & Haber, 2013). The sections of the Bank Holdings Company Act of 1956 that separated commercial banking from the insurance business, were also repealed. Thus, the GLBA permits single holding companies to offer banking, securities and insurance, as they had prior to the Great Depression (White, 2010).

The articulated rationale for the passage of the GLBA was that technological developments that eviscerated the traditional distinctions between commercial and investment banks had already occurred (Calomiris & Haber, 2013). These technological innovations made traditional commercial banking obsolete. According to this view, if the nation's commercial banks were to survive, they would have to move into new, more profitable areas like investment banking (Wall, 2014).

This meant that the GLBA was at its core, ostensibly a bailout bill for the banking industry. The justification for the statute was that it was required to rescue a commercial banking industry that was thought to be obsolete (White, 2010). The Act's proponents maintained the manner in which the banking industry could be saved, was to allow banks to merge with non-banking financial firms. Furthermore, the privacy provisions of the GLBA made it difficult for firms to remain independent of the financial services conglomerate envisioned by the statute. Firms that tried to remain independent would find that their inability to obtain useful information regarding their clients would hamper their ability to compete (Calomiris & Haber, 2013).

Consequently, due to relaxed Wall Street regulations, in addition to Basel II not having been prescribed in the US at that time, during the fall of 2008, an unprecedented large number of financial institutions collapsed, which resulted in a freeze of global credit markets and required government intervention worldwide (Crawford, 2011). This banking collapse caused a severe recession in economies around the world. The seeds of this panic were sown in the credit boom that peaked in mid-2007, followed by the meltdown of subprime mortgages and all types of securitized products (Ivashina & Scharfstein, 2010).

As a result of the credit crisis of 2007 – 2009, the Dodd-Frank Act was signed into law on 21 July 2010. The credits crisis, which was considered as the worst financial crisis since the Great Depression of 1929, was exacerbated by financial instruments and new forms of financing that were not dreamed of in the earlier era. The enactment of the Dodd-Frank Act was deemed necessary, as government bailouts of banks and large financial institutions reached well over US $100 billion in 2008 (Lu & Whidbee, 2013). Consequently, it became evident that the existing regulatory framework could not adequately oversee these institutions (Skeel Jr, 2010).

The Dodd-Frank Act led to a new epoch in financial regulation. The old epoch dated back to the early 1930s, when the Glass Steagall Act was passed in 16 June 1933, dismantling giant Wall Street banks and putting deposit insurance in place for the first time (Lucas Jr & Nicolini, 2014). Never again, they promised, would investors be forced to live by their wits in unregulated markets, or ordinary Americans lose their life savings if their bank failed (Skeel Jr, 2010).

The findings in this paper contribute to the literature in several ways. Firstly, the extent to which current legislation might have had an impact on the risk-taking of five preselected international banks, is demonstrated. In addition, the extent to which risk-taking by these banks had an impact on their reputation, is pointed out. The importance and relevance of the z-score as a measure of bank insolvency are also briefly highlighted. Furthermore, as one of the primary objectives of the

Dodd-Frank Act is to reduce risk-taking in banks, this research provides direct evidence, within the means of the study limitations, on whether or not this objective is being achieved.

The paper is set out as follows: A literature study which details the Dodd-Frank Act with focus on international markets is provided in Section 2. This is followed by a correlation between legislation, risk-taking, market value and reputation in Section 4. The research methodology is mentioned in Section 4 and the results obtained is presented in Section 5. A conclusion follows in Section 6.

2. LITERATURE REVIEW

The banking industry plays a significant role in both the financial system and the economy as a whole. By the end of 2012, the US banking system owned US $14.45 trillion in assets. During the second quarter of 2013, earnings grew by 23% to US $42.3 billion, marking the 16th consecutive quarter of rising earnings (Staunton, 2014).

However, the importance of the banking industry extends beyond its size. Bernanke (2013) indicated that the health of this sector has significant effects on overall economic activity, as well as the size and persistence of economic cycles. As a result, banking regulation has undergone tremendous change over time, with extensive regulations put in place in the 1930s, which was later removed in the last quarter of the 20th century (Kroszner & Strahan *cited in* Rose, 2014).

The banking industry has consequently been subject to extensive government regulation, including what prices (i.e. interest rates) banks may charge, the activities they may engage in, the risks they may and may not take, the amount of capital they must hold, and what location they can operate in (Da Silva & Divino, 2013). Banks are also subject to regulation by multiple regulators at both the state and federal levels; even banks that operate at a single location are likely to be regulated by at least one state and two federal bodies. The US system of prudential regulation and supervision of banking is without doubt a complex structure, due to the fact that it is not centralized in a single regulator, but is the responsibility of a number of separate and independent regulators (Kroszner & Strahan *cited in* Rose, 2014). Furthermore, bank regulation and supervision are separate from other functions in order to ensure financial stability, including Lender of Last Resort (LOLR) and deposit insurance, which gives rise to competing responsibilities and claims.

As is evident, a complex banking structure creates the necessity for complex law. In part, this legal complexity is also a response to the increasing complexity of social interactions and economic exchanges in society (Gambacorta & Rixtel, 2013). However, in many instances, the growth of

legal complexity appears to be outpacing the scalability of an approach that relies exclusively, or substantially, on human experts and the ability of clients to absorb and act on the advice provided (Lippe, Katz & Jackson, 2014). The Dodd-Frank Act is detailed in the following section.

2.1 Dodd-Frank Act

The Dodd-Frank Act is a noteworthy example of regulation designed to respond to the complexity of modern industry. Furthermore, it is an example of a regulatory approach that challenges the capacity of the legal profession to scale to the task. A requirement of the Dodd-Frank Act is that large banks must develop a resolution plan (Grant, 2012; Seligman, 2015) in which they explain how they could either be dismantled or survive the failure of one part of the institution (Lippe *et al.*, 2014).

Section 165(d) of the Dodd-Frank Act, requires each non-bank financial company supervised by the Federal Reserve System (Fed), and each Bank Holding Company (BHC) with assets of US $50 billion or more, to report periodically to the Fed, the Federal Deposit Insurance Corporation (FDIC), and the Financial Stability Oversight Council (FSOC), which is an interagency supervisory body created by Dodd-Frank (Grant, 2012; Barth, Dearie, Skeel & Wilmarth *cited in* Shultz, 2014*).*

Section 165(d)(8) of the Dodd-Frank Act required the Fed and the FDIC to issue joint final rules implementing section 165(d) by no later than January 2012 (Grant, 2012). These rules require a strategic analysis by the company of the manner in which it can be resolved under the Bankruptcy Code, Chapter 11 of the United States Code, in a way that would not pose systematic risk to the financial system (Barth et al. *cited in Shultz,* 2014).

The problem with the Dodd-Frank Act, however, lies not with its two objectives. These objectives are right on target. The problem lies with how they are handled (Bettencourt, 2014). The two themes that emerge, repeatedly and unmistakably, from the two thousand pages of legislation are (1) government partnership with the largest financial institutions (Kim & Muldoon, 2015) and, (2) ad-hoc interventions by regulators rather than a more predictable, rules-based response to crisis. Each could dangerously distort American finance, which will make it more politically charged, less vibrant, and further removed from basic rule-of-law principles than ever before in modern American financial history (Skeel Jr, 2010).

The first theme is government partnership with the largest Wall Street banks and financial institutions (Kim & Muldoon, 2015). The Dodd-Frank Act singles out a group of financial

institutions for special treatment. The banks that meet the US $50 billion threshold, and the non-bank financial institutions designed by the new FSOC as systematically important will be put in their own separate category (Ludwig, 2012). Furthermore, there is no serious effort to dismantle the largest of these banks or to meaningfully scale them down. As they are special, and because no one really believes the largest will be allowed to fail, they will have a competitive advantage over other financial institutions (Bettencourt, 2014).

The second theme overlaps with the first: the Dodd-Frank Act enshrines a system of ad-hoc interventions by regulators that are separated from basic rule-of-law constraints. The unconstrained regulatory discretion reaches its peak with the new resolution rules for financial institutions in distress (Skeel Jr, 2010).

The Dodd-Frank Act resolution is designed for systematically important financial institutions that have been singled out for special treatment. However, the rules do not require that an institution be designated as systematically important. Should regulators want to take over a struggling bank, they can simply do so as long as they can honestly say that it is 'in default or in danger of default' and its default could have 'serious adverse effects' on stability (Evanoff & Moeller, 2014). Furthermore, they may be able to take over every affiliate in the bank's network (Richardson *cited in* Evanoff & Moeller, 2014). Once the institution is in government hands the FDIC can pick and choose among creditors, deciding to pay some in full and leaving the rest with the dregs that remain after the favored creditors are paid (Skeel Jr, 2010).

Although the overall pattern of the legislation is disturbing, a handful of its contributions could genuinely improve the regulatory landscape. Though there are substantial uncertainties, the new framework for clearing derivatives and trading them on exchanges holds an unequivocal advantage (Allen, 2014 Johnson, 2015). The reforms promise to make the derivatives markets far more transparent than in the past (Johnson, 2015), and to diminish the risk that the default of a major financial institution will cause upheavals throughout the financial markets (Skeel Jr, 2010).

A second step forward is the new Consumer Financial Protection Bureau established by legislation (Evanoff & Moeller, 2014) to serve as a consumer watchdog with respect to credit card and mortgage practices. Although the new Bureau will be part of the Fed (Clarke & Zywicki, 2013), it will be almost completely insulated from second-guessing by the Fed or other bank regulators. It has been argued that the Bureau has been given too much power, and consumers' interests were woefully underrepresented during the credit crisis of 2007 – 2009. Although consumer protection

will remain within the Fed, it will be far more robust now that it is a separate operation (Skeel Jr, 2010).

On 7 January 2015, the restrictions the Dodd-Frank Act placed on large banks such as JP Morgan Chase and Citigroup, were scrutinized by Republicans, with the ultimate goal to relax these restrictions (Johnson, 2015). The first step in this direction was the formation of a bill to 'make technical corrections' to the Dodd-Frank Act. On 21 May 2015, the Senate Banking Committee approved, by 12 to 10 vote, a financial regulatory reform package developed by the Committee's Chairman that includes the most significant changes to Dodd-Frank since the law was enacted in 2010. These changes include: (1) raising the asset threshold that subjects banks to enhanced prudential standards from the Fed from US $50 billion to US $500 billion; (2) allowing for most loans that lenders hold in portfolio to be classified as qualified mortgages to determine their compliance with the Consumer Financial Protection Bureau's (CFPB) ability-to-repay rule; (3) changing the process used by the Financial Stability Oversight Council (FSOC) to designate systematically important institutions (non-bank financial firms) to improve transparency; and (4) increasing the bank asset threshold from US $10 billion to US $50 billion, which triggers direct examinations by the CFPB (GreenbergTraurig, 2015).

It can be argued that these changes would bring regulatory relief to community and regional banks, which would boost the economy. However, contradictory arguments have been made that these amendments are going too far in developing banks' provisions of Dodd-Frank, which was put into place to prevent another crisis.

3. RISK-TAKING, UNCERTAINTY, AND REPUTATION

Literature which dates back as far as the 1980s indicate that excessive risk-taking in the banking industry, with slack regulatory supervision, has dire economic consequences (Bernanke, 1983; Calomiris & Mason, 1997, 2003a, and 2003b). The last of which was the credit crisis of 2007 – 2009; a crisis so detrimental it has in fact been deemed the worst financial crisis since the Great Depression of 1929. The credit crisis is viewed by some as either a direct or indirect result of the repeal of the Glass Steagall Act, which saw the enactment of the Gramm-Leach-Bliley Act, an advocate for relaxed regulation (White, 2010; Crawford, 2011). There is also general consensus among economists and policymakers that trust and confidence played significant roles in the credit crisis and was central to any effective recovery plan (Earle, 2009).

As a result of the credit crisis, attention was refocused on the importance of the reputations of financial industries and banks. As these institutions provide a variety of services to client firms,

reputation should be especially important when a bank aims to maintain or increase its market value, as a bad reputation leads to lower market values for equity sold in the future (Fernando, Gatchev, May & Megginson, 2012). An example of this would include Wells Fargo & Co., an American multinational banking and financial services holdings company, with one of the worst reputations for customer service in 2012. Compared to JP Morgan Chase, another American multinational banking and financial services holdings company, whose stock rose by 29.4%, Wells Fargo & Co.'s stock rose only 16%, in 2013. Although numerous factors can have an impact on a company's shares, these two companies comparatively provide at least some indication that reputation has an impact on market value as they are both financial institutions and thus compete in the same market (Reuters, 2013).

Reputation is equally important for high quality financial institutions and banks to credibly distinguish themselves from low quality banks that presumably have a bad reputation and a low market value. This would require high quality banks, with a good reputation and a high market value, to expand significant resources in building and maintaining reputation (Fernando *et al.*, 2012).

Not only was a revised regulatory framework required but the new legislation had to account for trust, confidence, reputation and risk-taking. As a result, on 21 July 2010, the Dodd-Frank Act was enacted with two very strong objectives. The first was to limit the risk of contemporary finance, often referred to as shadow banking, and the second was to limit the damage caused by the failure of a large financial institution (Skeel Jr, 2010).

As mentioned, the objectives of the Dodd-Frank Act were sound; however, some argue that only once the Act was in place, did officials attempt to understand the very lengthy and complex piece of legislation. In addition, some banks reported an increase in profits, which could be attributed to numerous factors. One of these factors might have been increased risk-taking. For the purposes of this paper the researcher investigated whether increased profits could in any way be attributed to an increase in risk-taking. Hence, it was investigated whether the legislation in place (the Dodd-Frank Act) limited risk-taking in banks. The following propositions were consequently formulated.

Proposition (1): Current regulatory supervision might not limit risk-taking in the banking and financial industries sector.

Proposition (2): Risk-taking might have an impact on the market value of a bank or financial industry.

Proposition (3): The market value of a bank or financial industry might reflect its reputation.

4. RESEARCH METHODOLOGY

4.1 Stability

As a result of excessive risk-taking, the Dodd-Frank Act was enacted with two objectives, only one of which forms part of this paper. This objective was to limit risk-taking, which is measured by means of z-scores developed by Roy (1952); Hannan and Hanweck (1998); Boyd, Graham and Hewitt (1993); and De Nicolo (2000). The z-score is a measure of bank stability and indicates the distance from insolvency.

The probability of insolvency can be expressed as $prob(-ROA < CAR)$ where ROA is return on assets calculated as π/A and CAR is the capital-to-asset ratio calculated as $E/$A. Should profits follow a normal distribution, it can be illustrated that z = (ROA+CAR)/SD(ROA), which is the inverse of the probability of insolvency (Beck & Laeven, 2006; Beck, Hesse, Kick & Von Westernhagen, 2009; Mirzaei, 2013). More specifically, the z-score indicates the number of standard deviations that a bank's ROA has to fall below its expected value before equity is depleted and the bank is insolvent (Roy; 1952; Hannan & Hanweck, 1998; Boyd *et al.*,1993; De Nicolo, 2000).

4.1.1 Model Diagnostics

As this model has been used extensively in literature, it is important to emphasize its relevance and importance. As such Chiaramonte, Croci and Poli (2015), confirmed that the z-score was still very relevant and could in fact be compared to CAMELS (Capital, Asset Quality, Management Earnings, Liquidity, and Sensitivity to market risk) variables. Chiaramonte et al. (2015) examined whether the z-score was an accurate tool to predict bank distress on a sample of banks from 12 European countries, in addition to placing focus on the empirical attractiveness of the z-score.

These researchers found that (1) the z-score indicates good predictive power to identify bank distress, (2) that the z-score performed similarly to the CAMELS variables however the z-score had the advantage of being more parsimonious than CAMELS models, as it demanded less accounting and questionable data. Such a result is valuable for stakeholders, as they rely solely on available public information and seek simple and reliable measures of bank soundness (3) that the predictive ability of the z-scores held true, even when using several different computational approaches, and (4) that the z-score was slightly more effective when the organizational and

productive complexity of banks increased along with the public incentives to scrutinize bank riskiness, as is the case for large banks.

4.2 Population, Sample, and Data Collection

This paper comprises two samples, as a fully systematic test of bank risk-taking would require data from all international banks required to adhere to the Dodd-Frank Act, which would not be feasible. Since it is only required of each non-bank financial company supervised by the Fed, and each BHC with assets of US $50 billion or more, to adhere to the Dodd-Frank Act regulations, only five major financial institutions were identified. The financial data obtained are publicly available and were analyzed from 2008, since the Dodd-Frank was only enacted in July of 2010. The data used in the analysis specifically included the data gathered from the balance sheets and income statements contained in the annual reports of the identified international banks. The second data sample comprised publicly available data on the market value of each individual financial institutions from 2008 to 2016. The data were used to determine what the effects of risk-taking were on share price movement and consequently, banks' reputations.

4.3 Data Analysis

To test for Proposition (1), the z-scores for the individual banks, as well as the mean z-score, was calculated using Microsoft Excel, as only basic descriptive statistical analyses was used.

To test for Proposition (2), the Statistical Package for Social Sciences (SPSS), was used to perform more advanced statistical analysis by means of correlation and analysis of variance (ANOVA) of share value and z-scores. ANOVA was applied to determine if the mean dependent variable scores obtained differed significantly. This was achieved by determining how much variation in the dependent variable scores (share value) was attributable to the independent scores (z-scores).

To test for Proposition (3), a literature review was conducted.

5. RESULTS AND DISCUSSION

5.1 Descriptive Statistics

Two timelines were used in order to accurately predict the impact that new legislation might have on the risk-taking, and also on the market value of the banks. The first time period under investigation was 2005 to 2009, a period just prior to the enactment of the Dodd-Frank Act. The second period was from 2010 to 2014, a period in which the Dodd-Frank Act was active.

The data in Table 1 indicate the descriptive statistics for the analyzed variables from 2005 to 2009. The net income is also indicated, which was analyzed from the financial statements of five major banks, and reached a minimum of negative US $27 684 billion, maximum of US $24 600 billion, and a mean of US $7 936 billion. The large deviation can be attributed to the credit crisis, which had a major impact on profits as well as the differentiation in the sizes of banks.

The second important variable is the share value. For the purposes of this paper the focus was on the impact that legislation might have had on the share value, hence the overall mean of the share value of the five banks between the two predefined periods needed to be compared. The mean indicated in the table was calculated as US $63.83.

The z-scores varied from -1.07 to 3.52 with a mean of 1.74 and a standard deviation of 1.18. The dramatic downturn in the economy as a result of the credit crisis had a major impact on the z-scores, as did all the variables. This would explain the negative z-scores experienced during this time. The maximum z-scores was expected, as some banks did not experience the hardships of the credit crisis as much as others.

Table 1: Descriptive Statistics from 2005 to 2009

	N	Minimum	Maximum	Mean	Std. Deviation
Net Income (US$)	25	-27684	24600	7936.20	10120.42
Share Value (US$)	25	3.78	211.31	63.83	51.31
z-scores	25	-1.07	3.52	1.74	1.18

Source: Researcher's own deductions, 2016

The data in Table 2 indicate the descriptive statistics from 2010 to 2014, a period during and after the enactment of the Dodd-Frank Act. A mean net income of US $8 630.76 billion, with a mean share value of US $ 51.69 was calculated. The z-scores were analyzed with a minimum of 0.00, a maximum of 16.06, a mean of 5.16 and a relatively large standard deviation of 5.18. The large standard deviation can be attributed to the recovery period after the credit crisis.

Table 2: Descriptive Statistics from 2010 to 2014

	N	Minimum	Maximum	Mean	Std. Deviation
Net Income	25	-2238	21762	8630.76	6651.28
Share Value	25	3.90	172.52	51.69	50.48
z-scores	25	0.00	16.06	5.16	5.18

Source: Researcher's own deductions, 2016

5.2 Proposition Testing Results

Proposition (1): From the data in Table 1 and Table 2 it is evident that the z-scores as a measure of insolvency, had increased from time period one (2005 to 2009) to time period two (2010 to 2014). The mean z-score for period one was 1.74 with the mean z-score for period two being 5.16. This is a dramatic increase of 3.42, which indicates that if risk-taking is a measure of solvency, the five banks on average were much more risk averse, lowering risk-taking with the enactment of the Dodd-Frank Act. This indicates that the risk-taking decreased during and after the period of enactment of the Dodd-Frank Act. Thus, Proposition (1) might not be valid.

Proposition (2): Was tested using inferential statistical tests, which consisted of simple linear regression and ANOVA tests. The dependent variable is share price. The results of regression risk-taking on market value between 2005 and 2014 are indicated in Table 3. The linear regression analysis tested the relationship between the five major international banks' risk-taking (z-scores) and the share price.

Table 3: Regression and ANOVA of z-scores on market value

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.003[a]	.000	-0.21	4.14

a. Predictors: (Constant), share price

ANOVA (Analysis of Variance)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0.009	1	0.009	0.001	0.982[b]
	Residual	824.14	26	17.17		
	Total	824.15	27			

a. Dependent Variable: z-score

b. Predictors: (Constant), share price

Coefficients[a]

Model		Non-standardised Coefficients		Standardised Coefficients	t	Sig.
		β	Std. Error	Beta		
1	(Constant)	3.437	0.893		3.85	0.00
	Share price	0.00	0.012	0.003	0.023	0.982

a. Dependent Variable: z-scores

Source: Researcher's own deductions, 2016

From the results it can be deduced that the independent variable (share price) depicts -21% of the changes to the dependent variable. In addition, the data in the ANOVA table indicate that the model was insignificant, which infers that the changes in the dependent variable are insignificant to the independent variables with a sig. value of 0.982. Further to this, the Beta values from the Coefficient table are the regression equation (B_0 = 3.437; B_1 = 0.00). The standard Error for the Constant indicates that at an $\alpha = 0.05$ and degrees of freedom (df) of 26, the Beta of 3.437, falls between the range of 1.381 and 5.493. This was calculated with a critical value of 2.056. Taking $\alpha = 0.05$ with df of 26 and a critical value of 2.056, this can be computed for all the variables.

The t-value is derived by dividing the Beta with the Standard Error. This value is used to determine if the data is statistically significant. However, the data analysis provided Sig. values, and with a Sig value > 0.05, the data is statistically insignificant. Thus, Proposition (2) is not valid.

Proposition (3): A good reputation is dependent on ethical behavior including factors such as marketing strategies, treatment of employees, care of the environment, and honest financial

reporting. In addition, Smith, *K.T., Smith, M. and Wang* (2010) found evidence that firms with a higher reputation have higher market value. The results indicated that these firms do enjoy a market value premium. They concluded that reputable firm behavior creates a valuable tangible asset that is distinct from industry peers. In addition, the results supported the impression management theory, in that those businesses that can effectively direct reputation management activities, will receive tangible economic and other benefits, in this case an increase in the wealth of the corporate stockholders. Thus, Proposition (3) might be valid.

6. CONCLUSION

The researcher of this paper aimed to prove three propositions. In order to determine the validity of Proposition (1), the descriptive statistics of the net income, share value and z-scores for two determined time periods (2005 – 2009 and 2010 – 2014) were analyzed. Z-scores were used to determine risk taking. The results indicated that the mean z-scores did increase, which indicates that Proposition (1) might not be valid. Proposition (2) was also nullified by the ANOVA of z-scores and share value. The results indicated that the z-scores had no direct impact on share price with $p = 0.982$. Proposition (3), however, might be valid as a literature review evidencing the relationship was conducted. Previous studies had also conducted similar empirical research, which resulted in similar conclusions.

Consequently, since the data that were used indicate that the Dodd-Frank Act might lower risk-taking by banks, which means its objectives were reached. As a result, the regulatory bodies in place have enacted a piece of legislation that not only limits risk-taking but in turn might have an effect on reputation and reputation risk. If it is perceived by the public that banks take on less risk, the banks' reputation might benefit. However, risk-taking, reputation and misconduct in banking, are topics that require further research.

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CHAPTER 4

ARTICLE 3

ASSESSING REPUTATIONAL RISK: AN INTERNATIONAL FOUR POINT MATRIX

Ezelda Swanepoel, Ja'nel Esterhuysen, Gary van Vuuren, Ronnie Lotriet[3]

Abstract

Corporate strategies have been increasingly confronted with the need to measure and manage corporate reputation. Despite the importance associated with measuring and assessing reputation risk, the effectiveness of techniques that accomplish these tasks has 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. The matrix comprises four key aspects ("who", "where", "what" and "how"): each assesses the degree of risk posed to reputation. 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' know your client.

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

JEL Classification: G21, G32

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 so today, with large volumes of assets churning though 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

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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 stakeholder relationships (Young & Hasler, 2010 and Lizarzaburu, 2014).

Since reputation and managing reputation are essential, reputation 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 reputation 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 reputation 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 may 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, 2014). A good reputation can increase customer confidence in products or advertising claims, 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 this proposed here should enable a company to be proactive, and adequately track (and thereby improve) their 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 as 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 Bogeard & 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-focussed 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 Bogeard & 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 by 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 also include 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 & Soenen (1999) and Gioia & 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 & 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 matrix may prove to be superior because focus is placed on individuals, processes, place and type of business, factors which also help to establish the matrix to be more comprehensive.

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

3. MEASURING REPUTATIONAL RISK IN A QUALITATIVE MANNER

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 suspicions. Banks are exposed to large amounts of clients so it is vital that banks have an understanding of the clients which 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 client's 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 suspicions 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 to assess this factor proves in the recent US-MENA Private Sector Dialogue held in New York in October 2014 provided insight on current trends in banking. It was stated that with the onslaught 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 reputation 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 $US 21 trillion, or nearly 18% of the aggregate global wealth. The figures for the shadow banking industry are 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 been recently-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 which include 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 up 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 accompany 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" includes 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, they 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 who maximise profits.

Service provides 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 misguide 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; 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 U.S Commodity Futures Trading Commission (CFTC), the U.S 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, 2014).

4. RESEARCH 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 them. 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 were obtained from a retail bank in South Africa to perform a reputational risk assessment with reference to the clients that they services, the intermediaries they utilise (the "who") and the jurisdiction of Mauritius in which they operate (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. Mauritius 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 will consist 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) argues 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 towards AML practices have increased due to two assumptions: money laundering is a serious crime and the incidence of laundering must be lowered though 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.

Table 1: Template of "who" assessment of reputational risk.

	Control deficiencies			
	Know your client	Source of wealth	Client intent	Ultimate beneficial owner
Business Unit 1				
Business Unit 2				
Business Unit 3				

4.2 Template "where"

The template which determine the "where" aspect of the reputational risk assessment composes of seven individual factors, each to be assessed (for the purposes of this study) to determine the possible risk they may pose to the banks' 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 needs 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.

Differentiating proposition	As a jurisdiction to clients in Africa
Location	
Tax	
Operational costs	
Quality	
Regulatory compliance	
Track record	
Ease of doing business	

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 clients risk profile. There are two aspects to be assessed regarding the nature of the product including whether or not the product is within the bank's recommendation capability and is the product in line with regulatory expectations?

The findings are documented upon which potential areas of risk will be identified. 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 will be evaluated on a three point scale to ultimately determine the risk level. If the potential area of risk should prove to be of very little to no threat to reputational risk it would receive a value of one, should the potential are of risk prove to be of medium risk or should there be some room for improvement it would receive a value of two out of three. Finally, should the potential area of risk prove to be high or detrimental to reputational risk, it would receive a value of 3.

Table 3: Template of "what" assessment of reputational risk.

Focus area	Findings/ assessment	Potential risk area	Risk level
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 banks' capability to appropriately recommend, monitor and manage?			
Commercial purpose of products and services			

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 to important categories which will assess the business practices and the systems and tools. In the assessment of business practices aspects, pricing incentives and the sustainability of these practices will be taken into consideration. With regard to the assessment of systems and tools two important factors will be analysed which include reporting procedures and determining if the Management and Insurance (MI) practices to manage risks are copacetic.

Table 4: Template of "how" assessment of reputational risk.

Focus area	Findings/assessment	Potential area of risk	Risk level
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			

5. RESULTS AND DISCUSSION

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

Table 5: Data depicted in template "who".

	Control deficiencies			
	Know your client	Source of wealth	Client intent	Ultimate beneficial owner
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

The scores indicate which particular business unit views which control deficiencies as a potential reputational risk, i.e. the wealth business unit indicated that they view 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 they bank potentially high risk source of wealth customers. 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, which included 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. Their customer base includes foreign nationals (including South Africans). They have 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, bank companies whose ownership vest 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 which are 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 involves little structuring and 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 stringiest 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 is 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 branches' 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 political-, economic- 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".

Differentiating proposition	As a jurisdiction to clients in Africa
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 1st in Africa, often ranked 2nd next to RSA and Botswana.
Ease of doing business	1st in Africa.
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.

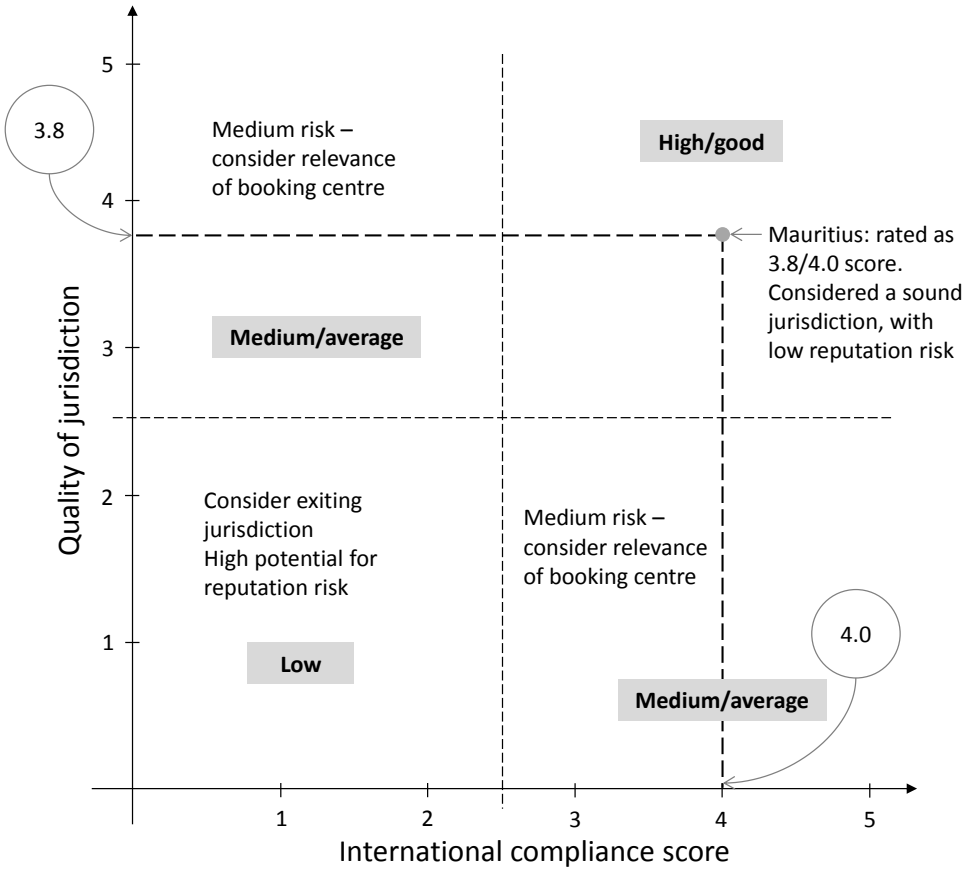

Figure 1: External jurisdiction assessment.

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 the 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 indicated that all the aspects accept the suitability of the products relative to the clients risk profile, which received a medium-risk rating, received a low-risk rating.

Table 7: Data depicted in template "what".

Area	Findings/assessment	Potential area of risk	Risk level
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 banks' 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

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".

Focus area	Findings/assessment	Potential area of risk	Risk level
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 contain all banking charges (ABC) clauses, as is the practice in the local market, no referral fees are paid by the bank to introducers.	1
rovide 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. • 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.	1
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

Table 9: Four point reputational risk matrix.

Reputational risk level	Findings		Risk rating	Overall risk rating
Who	KYC	Medium risk	3	3
	Source of wealth	Low risk	1	
	Client intent	High risk	5	
	UBO	Medium risk	3	
Where	Quality	4.15	1	1
	Compliance	4.2	1	
What	Products	Low risk	1	1.4
	Suitability	Low / Medium risk	2	
	Expectations	Low risk	1	
	Capabilities	Low risk	1	
	Purpose	Low / Medium risk	2	
How	Sustainability	Low / Medium risk	2	1.5
	Interests	Low risk	1	
	Reporting	Low risk	1	
	MI	Low / Medium risk	2	

6. CONCLUSION

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 tests the hypothesis, however, any type of financial organisation, nationally or internationally, can utilise this matrix to measure their reputational risk or aspects which might pose a threat to their 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 make 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 sell vanilla products and all tax structuring and complex trusts have been terminated in accordance with local regulation. The Mauritius branches' 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, we propose they invest in IT systems to strengthen KYC.

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CHAPTER 5
CONCLUSION, RECOMMENDATIONS AND A PROPOSED REPUTATIONAL RISK MEASUREMENT FRAMEWORK

5.1. INTRODUCTION

The purpose of the final chapter, Chapter 5, is to provide an overview and a motivation for the three articles published or in some cases accepted for publication. This chapter will entail a description of the vision and strategies, followed by the predefined deposit-taking institutions' vision and strategy as well as the contradictory findings. In addition, the contribution, recommendations and future research suggestions will be detailed.

The primary objective of the study was to evaluate the effectiveness of current reputation- and conduct risk practices in the international banking environment (US) in order to construct a framework to be used to measure and manage reputational risk. This has been completed by means of z-scores compared between the period before the Dodd-Frank Act was enacted and a period thereafter. It was concluded that, as one of the major objectives of the Act is to limit risk taking, the Act, in fact, is effective and relevant to current conduct risk practices. In addition, a conceptual framework was designed and tested in the South African banking environment for validity.

The secondary objectives of the study included the clarification of concepts or reputational- and conduct risk as well as their relationship, which was discussed at length throughout. It was found that when US deposit-taking institutions have legislation in place designed to limit regulation (Gramm-Leach Bliley Act) they engage in misconduct practices, which in turn lead to reputational damage. Further to this, the current misconduct practices (credit crisis of 2007/09, Libor, Euribor, PPI and Forex scandals) were analysed. In addition, in Chapter 4, Article 3, a measuring instrument was constructed to measure reputational risk upon which a valid and reliable conceptual framework to reconstruct current legislation and regulation practices was designed and tested in the South African environment to test for validity.

5.2. VALUE STATEMENTS

The proceeding section will detail the vision and strategies of the different deposit-taking institutions analysed in this study. As mentioned in Chapter 1, Section 1.6, Morgan Stanley was excluded from this section, as only their form 10-K was publicly available with limited information

on their vision and strategy. The proceeding section will form the basis as to which of these deposit-taking institutions have placed their clients and specifically their shareholders under false pretence. This section is to be followed by the findings of each article, which will emphasise this circumvention of truth.

5.2.1 Bank of America value statements

As mentioned in Chapter 1, in Bank of America's annual report of 2010 they stipulated that they believe they are capable of meeting their clients' financial needs more effectively than any other company. In addition, they stated they are customer-driven, aim to clean up their legacy issues and strive to be the best place to work (Bank of America, 2010).

5.2.2 Royal Bank of Scotland value statements

In their annual report of 2010, RBS stated that their overriding focus was to achieve three things that include: (1) to serve their clients; (2) to restore the bank to undoubted standalone strength; and (3) to rebuild sustainable value for all shareholders (Royal Bank of Scotland, 2010).

5.2.3 Citibank value statements

In Citibank's annual report of 2010, it was stipulated that they tirelessly strive to serve individuals, communities, institutions and nations. They continue with emphasis on their efforts to strive to create the best outcomes for their clients with financial solutions that are creative and responsible (Citi, 2010).

5.2.4 Goldman Sachs value statements

In Goldman Sachs' annual report of 2010, it was stipulated that among others, integrity and honesty are at the heart of their business, as they expect employees to maintain high ethical standard in every endeavour (Goldman Sachs, 2010).

5.2.5 JP Morgan value statements

In JP Morgan's annual report of 2010 it was stated that they had 70 projects and work teams, all in place to assure regulatory changes. In addition, they ensure that they will meet all new rules and requirements, both in letter and in spirit and ensure that all their operations are done with the client foremost in mind (JP Morgan Chase and Co, 2010).

5.2.6 Barclay's value statements

Barclay's annual report of 2010 (Barclays, 2010) stated that they understood the importance of risk management and of the risk their clients undertake. In addition, it is mentioned explicitly that they understand that in order to execute their strategy it is essential they ensure that they retain financial discipline required to deliver returns.

5.3. SUMMARY AND MAIN FINDINGS

One enduring question about the financial turbulence that engulfed the world, starting in 2007, is how problems in a small corner of United States (US) financial markets (securities backed by subprime mortgages accounting for only 3% of US financial assets) could inflect the entire US and global banking systems. In addition, this inflection did not stop US bank failures, credit freeze-ups and sharp stock market declines have spread well beyond the borders of the US. The role international regulatory institutions have played in addressing the crisis is of paramount importance (Crawford 2011).

As is often the case with financial crises, many of the underlying factors leading to the credit crisis of 2007/09 arose from responses to previous cases. In this case certain underlying factors date as far back as the Great Depression of 1929 (Kroszner & Strahan, 2014). The 1920s was a period of then unprecedented optimism and economic growth in the US. It was also a period of financial excess, especially over-borrowing, lending and over-investments (Duchin *et al.,* 2010). The dramatic increase in stock prices in the 1920s had been underpinned by large amounts of lending for stock purchases. With the dramatic decline of the economy in 1929, lenders called in loans and borrowers were forced to sell assets, stocks, bonds, property, to name but a few, in order to repay their loans. This, however, triggered a further decline in asset prices, further margin calls and massive deleveraging. The process caused widespread losses to market participants and lenders, which resulted in loss of confidence in markets and among market participants. In consequence deposit-taking institutions failed, lending to businesses failed, consumption declined and investments collapsed (Kroszner & Strahan, 2014).

Eventually the process spiralled into a huge collapse of the 1930s, known today as the Great Depression of 1929. In addition to many corrective responses, the Roosevelt administration initiated the wholesale redesign of the US financial system through legislation and regulation designed to prevent the sorts of excess seen in the 1920s; reduce the risks of future financial crises becoming systemic; and ensure that the financial system supported economic growth rather than speculation. However, in the period between 1998 and 2004 a series of underlying events led to

the view that a new model of US banking had emerged. This US model was based on several elements, most importantly universal banking and the distribution business model, both of which received important support from international financial regulatory standards (Crawford 2011).

Unlike the system of finance established in the US in the 1930s the US model of finance was based on a European-style model of universal banking rather than on the US New Deal's strict sectoral separation. The Gramm-Leach-Bliley Financial Modernization Act of 1998 secured this aspect with the repeal of the Glass Steagall Act in 1999 (Wall, 2014). As a result of this change in the US, competition between commercial- and investment deposit-taking institutions for securities business increased drastically, forcing the investment deposit-taking institutions into ever more risky reliance on proprietary trading-speculating with their own capital and using leverage to increase returns.

Secondly, the model was based on securitisation. Under this model, deposit-taking institutions would originate assets, such as loans and then repackage these and sell them to investors. The resulting funds would be used to originate more assets, which in turn would be repackaged and sold, recommencing the cycle. Evidently, from both the standpoint of deposit-taking institutions and regulators, this model had benefits, however, these benefits, when taken to excess, also turned to be the greatest weakness of the new model (Crawford 2011).

As a result, towards the end of 2006, rising interest rates, subprime delinquencies and downgrades of structured products began to shake confidence in the new financial paradigm. By mid-2007, the tide had turned, which resulted in a freeze in markets in August 2007. Significant equity market corrections, cuts in interest rates and a seeming return to normal in the US stock markets, with foreign equity and global commodities markets simultaneously being propelled to new heights as money moved out of credit and into other opportunities. At the same time, the failure of Norther Rock in the UK in 2008 was followed by the beginning of the onset of the credit crisis globally as adverse selection, loss of confidence and changes in investor preferences weakened global credit markets (Linsley & Slack, 2013).

On September 15, 2008, Lehman Brothers, the fourth largest US investment bank, filed for Chapter 11 bankruptcy protection. With US $680 bn in assets, US $650 bn in liabilities and over 100 000 creditors around the world, this is the largest and most complex bankruptcy in history. This event would is seen as the trigger for the subsequent systemic crisis (Brunnermeier, 2009; Taylor, 2009; Campello *et al.*, 2010).

This thesis examined three fields of bank risk taking, namely reputation risk, conduct risk and legislation with reference to their impact on the credit crisis of 2007/09. Finally, a reliable, robust and accurate newly constructed framework was designed to be used nationally or internationally to measure and manage reputational risk.

5.3.1 Article 1 - Banking competition and misconduct: how dire economic conditions affect banking behaviour

This paper, accepted for publication in Banks and Bank Systems, aimed to demonstrate the manner in which the dire economic conditions impacted competition, performance, risk taking and conduct. As a result, there is a strong view that since the credit crisis (2007/09), more and more scandals emerged of deposit-taking institutions conducting illegal and immoral practices, which led to the main aim of this paper: to determine if dire economic conditions can lead to increased competition, which again can lead to misconduct by deposit-taking institutions.

Main topics detailed the recent credit crisis, Libor, Euribor, PPI, Forex scandals in the US and the UK. The paper also detailed the correlation between competition, misconduct and fines imposed on these deposit-taking institutions for their misconduct. This allowed for four propositions to be formulated.

Proposition (1): Difficult financial times could result in increased competition.

Proposition (2): Increased competition may result in increased risk taking.

Proposition (3): Risk taking levels could have an impact on bank's financial performance.

Proposition (4): Decreased financial performance may result in increased misconduct.

Each of these propositions were tested.

- For proposition (1) The literature review confirmed that dire economic conditions resulted in increased competition as there were reports of 'champagne bonuses' and 'a grand in your hand' for reaching targets. Furthermore, as a result of the credit crisis and hence, declining profits, deposit-taking institutions were forced to compete with the changing markets as well as keep their profits high as was experienced prior to the credit crisis.
- Proposition (2) was accepted based on the resulting z-scores from seven international deposit-taking institutions calculated from 2000 to 2006 (p1) and from 2007 to 2010 (p2). The mean z-scores decreased from 5.47 in (p1) to 1.41 in (p2), which indicates increased risk taking.

- Proposition (3) was accepted based on ANOVA of ROA, ROE and z-scores. The results indicated that the calculated z-score had an impact on the bank's ROA and ROE with a 0.00 significance level.
- Proposition (4) was accepted based on the fines imposed by the FSA and the FCA and based on the presumption that increased fines are a result of increased misconduct. From the period 2002 to 2006, the mean fines imposed amounted to £16mn and from the period 2007 to 2015 the mean fines amounted to £891 mn for an increase of £874 mn.

5.3.2 Article 2 - Dodd-Frank and risk taking: the impacts on reputation in modern banking

This paper, accepted in Banks and Bank Systems, demonstrates to what extent the current US legislation might have had an impact on the risk taking of six preselected international deposit-taking institutions. Based on the findings, the paper will also demonstrate to what extent the risk taking of these deposit-taking institutions might have had on their reputation and hence, their market value. The main topics under discussion were the Great Depression of 1929, which led to the enactment of the Glass Steagall Act and its eventual repeal with the enactment of the Gramm-Leach-Bliley Act and finally, the enactment of the Dodd-Frank Act. The paper also detailed the correlation between risk taking, uncertainty and reputation. This literature enabled the formation of three propositions:

Proposition (1): Current regulatory supervision (Dodd-Frank Act) might not limit risk taking (measured by z-scores) in the banking- and financial industries sector.

Proposition (2): Risk taking (measured by z-scores) might have an impact on the market value (measured by share value) of a bank or financial industry.

Proposition (3): The market value (measured by share value) of a bank or financial industry might reflect its reputation.

- Proposition (1) was rejected, based on the descriptive statistics of the net income, market value and z-scores, which were determined for two time periods (2005 – 2009 and 2010 – 2014). The results indicated that the mean z-scores did in fact increase, which would nullify Proposition (1). Hence, since the z-scores increase during period two, when the Dodd-Frank Act was enacted, risk taking declined, which is one of the major objectives of the Dodd-Frank Act. In consequence, the Dodd-Frank Act met its primary objective.

- Proposition (2) was also nullified by the statistical ANOVA of z-scores and share value. The results indicated that the z-scores had no direct impact on market value with p = 0.982. (Significance of P = 0.05)
- Proposition (3) was accepted as a literature review was conducted, which evidenced the relationship between the market value of a bank and its reputation. Previous studies had also conducted similar empirical research, which resulted in similar conclusions. In consequence, although the z-scores and hence, the legislation, might not have had a direct impact on the market value, the reputation declined from period one to period two as the mean share value for period one was US $ 63.83 and for period two it was US $ 51.69.

5.3.3 Article 3 - Assessing reputational risk: an international four point matrix

This paper, which was accepted for publication in the Journal of Economic and Financial Sciences, 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 may be used in any institution, but deposit-taking institutions provide the focus in this work, principally because of the R20 bn fine imposed on six major international deposit-taking institutions (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 money market interest rate, Libor.

Deposit-taking institutions' reputation and the management thereof impact the vast majority of individuals because so much damage has already been done. A good reputation can increase customer confidence in products or advertising claims, 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 deposit-taking institutions. A reputational assessment technique proposed by the research should enable a company to be proactive and adequately track (and thereby improve) their reputation.

Detailed topics in the article included ranking measures, reputational quotient and identity measures. This was followed by the detailed discussion of each of the four aspects of the matrix. Each of the aspects of the four point matrix were evaluated via a template termed a reputational heat map. Each of the four points had different aspects and criteria linked to them. From the data gathered, each aspect is assessed and rated as having either a high, medium or a low impact on a bank's reputation. Each aspect will have a focus area followed by the assessment and findings

thereof. The primary 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 findings are documented upon which potential areas of risk will be identified. 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).

A South African retail bank was used to determine the effectiveness of the framework. The underlying reason for the use of a South African bank was due to practicality (time and costs). It was found that the South African retail bank exhibits 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 detailed discussion on the significance of the findings and how the framework contributed will follow.

5.4. SIGNIFICANCE OF THE STUDY

The research has placed emphasis on the past, current and future reputational risk prospects and concerns of deposit-taking institutions. As mentioned, the study focused primarily on the measurement and management of reputational risk via several articles as well as the correlation between conduct risk and reputational risk. As is evident, current conduct practices have changed dramatically post the credit crisis (2007/9). These changes have raised questions regarding current legislation and regulations being enforced. The study investigated the current change in conduct after the credit crisis (2007/9). The study analysed factors, which contributed to the changes experienced in conduct and contributed by gathering data from the market, which was compared and reported. This analysis attested to the fact that conduct risk has either increased or decreased post the credit crisis (2007/9).

Furthermore, an analysis on the current significance and sufficiency of US legislation was conducted. This analysis will either prove or disprove that current legislation practices are sufficient, upon which suggestions will be provided.

The main contribution of the study included a newly constructed framework that placed emphasis on the manner in which reputational risk can be measured, which contributed significantly since no such framework currently exists. This framework aimed to indicate the relationship/correlations between conduct risk and reputation risk.

5.5. PROPOSED FOUR POINT MATRIX

The main purpose of the framework will be to assist individuals to achieve their ambitions in the correct manner. In this context, deposit-taking institutions must serve:

- The appropriate needs and objectives. This entails that they need to be tax efficient while ensuring full compliance and alignment with Group Tax Principles;
- Of appropriate clients. This entails they need to be transparent and accept identity, market association, source of wealth and intent.
- In appropriate locations. Jurisdictions need to comply fully with policy and the appropriate country's regulations and legislations. In addition, there should be a clear and defendable rationale for selecting of booking centres for all clients.
- With the appropriate products and services. Investment and trading needs to be consistent with documented risk profiles and client sophistication.
- The products and services must be delivered in a controlled and sustainable manner. Deposit-taking institutions need to be focused on a limited number of markets to ensure a high quality approach and full compliance with all local and cross-border regulations. There also needs to be full transparency to end clients of all introducer arrangements.

Further to this, the framework also provides guiding principles and applications to certain scenarios. The guiding principles include:

- Engage in business practices that ensure sustainability from the perspective of all stakeholders;
- Align interests between clients, deposit-taking institutions, colleagues; and
- Provide transparent, accurate and timely reporting (internal and external).

The application includes:

- Businesses and colleagues managed via balance scorecards, which include performance management and compensation;
- Do not pay or receive retrocessions (internal or external) built into the product/service value chain;
- No 'fly-ins' to prospect or serve clients in markets where comprehensive and up-to-date cross-border policies do not exist;

- Introducers must be contracted and comply with all relevant cross-border regulations if introducing clients from potentially restricted markets;
- Ensure full transparency to end clients of all revenue sharing arrangements; and
- Internal tax structuring is clearly explainable.

Table 5.1: Four point matrix summary

Who: Appropriate clients	Client profile	Serving clients who are potentially controversial due to their personal professional activities	Client intent	Inadvertently supporting clients to achieve inappropriate outcomes e.g. aggressive tax avoidance
	Source of wealth	Serving clients whose source of wealth is controversial, related to criminal activities or non-transparent	Underlying beneficiary	No transparent underlying beneficiary owner of the assets.
Where: Appropriate locations	Presence in certain locations	Presence in jurisdictions that pose explicit tax avoidance opportunities, politically unstable, demonstrate poor compliance to international standards	Choice of booking centre	Booking clients into inappropriate or illogical booking centres given their individual tax domicile, residency and/or location of their assets.
What: Appropriate services	Social purpose	Products and services that do not have a genuine commercial purpose other than tax, are unsuitable given the client's risk profile, objectives, mandate and level of sophistication.	Nature	Products and services that are not within the financial institution's capability to recommend and monitor appropriately.
How: Delivered in a sustainable manner	Business practices	Pricing and incentives that do not align with the interests between the client, the financial institution, colleagues and regulators.	Systems and tools	Reporting that is inaccurate, untimely and opaque.

Source: Researcher's own deductions, 2017

5.6 RECOMMENDATIONS FOR FUTURE RESEARCH

5.6.1 Reputational Risk

The study finds that there were inherent risks in offshore international banking, however, these appear to be well managed through the regulatory framework and strong management processes, so no strong recommendation is to be made. In addition, no tax advice or structuring was undertaken and the regulator did not allow deposit-taking institutions to structure trusts. Furthermore, introducers were found to be used for new businesses, however, the questions of government regulation, the provision of local management companies of administrative services and the remuneration by the client remain. To further their reputational risk, it is proposed that they invest in IT systems to strengthen KYC.

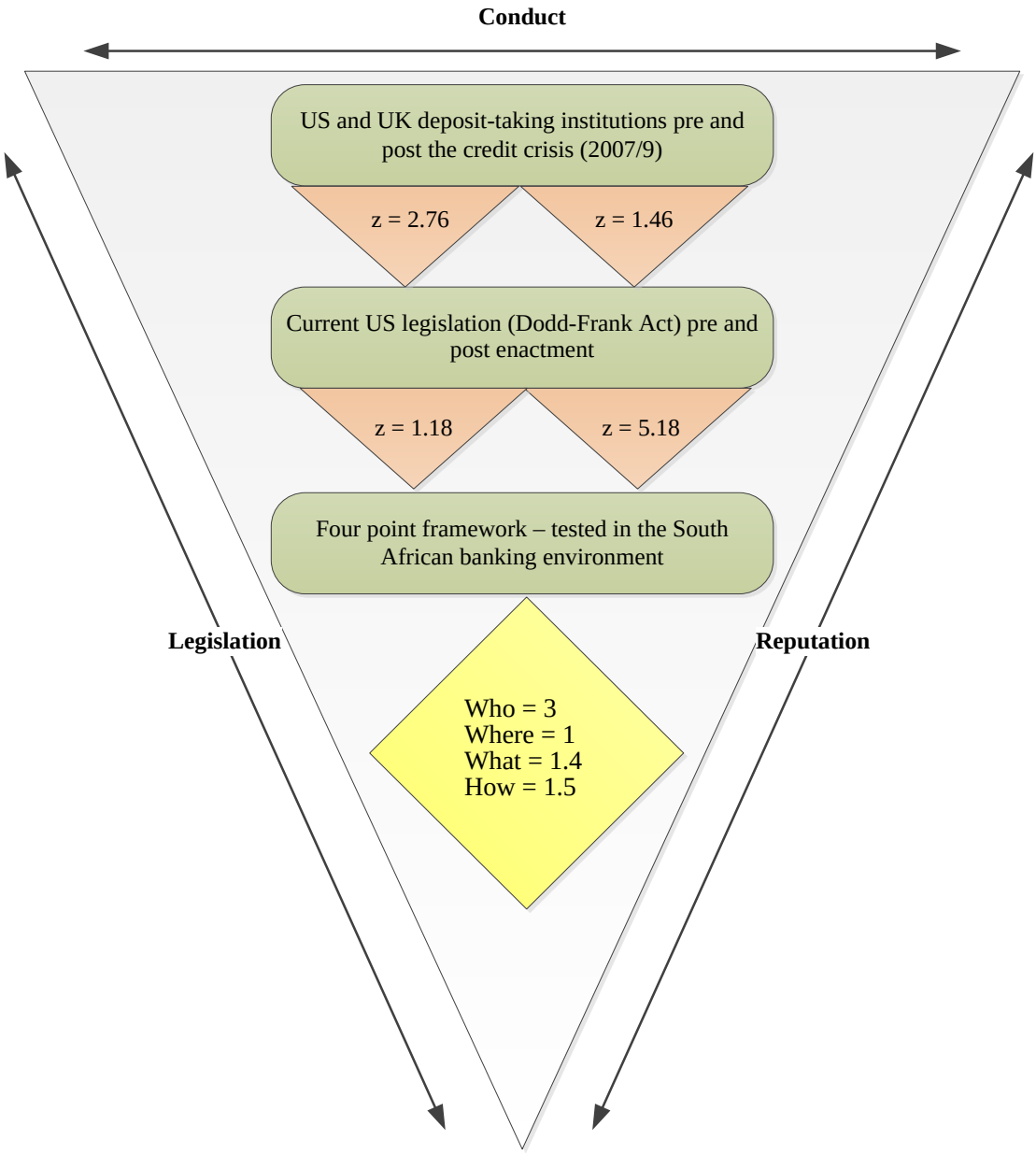
5.6.2 Regulation and Legislation

In consequence, since the study indicated that the Dodd-Frank Act might lower risk taking by deposit-taking institutions, it achieves the objectives it has set. As a result, the regulatory bodies in place have enacted a piece of legislation that not only limits risk taking but also in turn might have an effect on reputation and reputation risk. If it is perceived by the public that deposit-taking institutions take on less risk, the deposit-taking institutions' reputation might benefit.

However, the decisive recommendation would be to reinstate a revised Glass-Steagall Act as depository institutions possess enormous financial power, by virtue of their control of other's money and to this extent, it must be limited to ensure soundness and competition in the market for funds, whether for loans or investments. In addition, as securities activity can be risky, it can lead to enormous losses. Such losses could threaten the integrity of deposits. In turn, the government insures deposits and could be required to pay large sums if depository institutions were to collapse as the result of securities losses.

Lastly, depository institutions are supposed to be managed to limit risk. Their managers may not be conditioned to operate prudently in security businesses that are more speculative.

Figure 5.1: Graphical representation of thesis findings



Source: Researcher's own deductions, 2017

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ANNEXURE A

CONFIRMATION OF ACCEPTANCE OF ARTICLE 1, 2, AND 3

Dear Ezelda Swanepoel,

I would like to inform you that your paper titled " Banking competition and misconduct: how dire economic conditions affect banking behavior" has been accepted for publication (BS – 02 – 0916). Your paper will be published in the **issue 4, 2016** of the journal "Banks and Bank Systems".

With best regards,

Nataliia Petrina
E-mail: bbsexeceditor@businessperspectives.org
Accountable Secretary
International Research Journal
"Banks and Bank Systems"

Dear Ezelda Swanepoel,

We just received the answer from the Editorial Board. Your paper “Dodd-Frank and Risk-taking: Reputation Impact in Banks (BS-10-1116)” accepted for publication. It will be published in the Volume 12, Issue 1, 2017.

With best regards,
Nataliia Petrina
E-mail: bbsexeceditor@businessperspectives.org
Accountable Secretary
International Research Journal
"Banks and Bank Systems"

Dear Miss Swanepoel,

It is a pleasure to accept your manuscript entitled "Assessing Reputational Risk: A Four Point Matrix" in its current form for publication in an upcoming issue of the The Journal of Economic and Financial Sciences. Once the article has been language edited and set, you will receive a final version for sign-off.

Thank you for your fine contribution. On behalf of the Editors of the The Journal of Economic and Financial Sciences, we look forward to your continued contributions to the Journal.

Sincerely,

Prof. Gideon Els
Managing Editor, The Journal of Economic and Financial Sciences
gideone@uj.ac.za

ANNEXURE B

AUTHOR GUIDELINES FOR BUSINESS PERSPECTIVES – BANK AND BANK SYSTEMS

Requirements to the manuscripts

1. Abstract preparation guidelines

1.1. The abstract (200-250 words) should reflect the conceptual content of the article. In the abstract the author should give a brief overview of research importance, describe the subject matter and the aim of research, its methodology as well as highlight the most significant results of research.

1.2. Journal of Economic Literature (JEL) classifications that can be found at

http://www.aeaweb.org/jel/jel_class_system.php, and a few key words about the manuscript are necessary.

1.3. Font - Times New Roman; text size - 12 pts, line-spacing - one-and-a-half.

1.4. All tables and figures should be editable.

2. The paper main body preparation guidelines

2.1. The paper should present the result of independent original research undertaken by the author; it should contain the data never published before.

2.2. The paper should contain a clear description of research objective and its subject.

2.3. The methodology of research should be described in detail.

2.4. The author personal scientific contribution must be grounded in the paper.

2.5. The paper should contain basic suggestions on how to solve the problem under study.

2.6. American English has been preferred to British English.

3. The structure of the paper

3.1. The title of the paper.

3.2. Below, in the centre of the page the name of the author should be printed. Reference to the author's name should be made at the bottom of the page with the footnote marked by asterisk ("*").

The reference should contain information about the author's degree, position and the place of work as well as contact details (phone number, job or/and personal e-mail).

3.3. Below, the text of the abstract should be printed.

3.4. After the abstract's keywords and JEL classifications should be printed.

3.5. Below the main body of the paper should be placed.

3.6. The main body of the paper should be followed by references.

3.7. References contain the list of literature referred to given in alphabetical order.

3.8. All figures and tables should be printed inside the papers' main body.

4. References in the text

4.1. References in the text are made as follows: (Myers, 2000) / (Myers, 2000; Edwards, 2010) /

Barber, Odean and Zhu (2008) investigate...; the former being the name of the author, the latter - edition year.

4.2. Examples of references:

Alchian, A. and Woodward, S. (1987). Reflections on the Theory of the Firm, *Journal of Institutional and Theoretical Economics*, 143, pp. 110-136.

Berle, A.A. and Means, G.C. (1932). *The Modern Corporation and Private Property*, New York: Macmillan, 418 p.

Cremers, K. and Nair, V. (2005). Governance Mechanisms and Equity Prices, *Journal of Finance*, 60 (6), pp. 2859-2894.

5. Manuscript length

5.1. The paper should not be less than 2000 words and should not exceed 6000 words.

ANNEXURE C

AUTHOR GUIDELINES FOR

JOURNAL OF ECONOMIC AND FINANCIAL SCIENCES

INSTRUCTIONS FOR AUTHORS

Please follow these guidelines when preparing papers for submission to the Journal of Economic and Financial Sciences (JEF). This will assist us in producing the journal more speedily and efficiently.

1. SUBMITTING MANUSCRIPTS

As previously indicated all manuscripts should ONLY be submitted electronically in Microsoft® Office Word 2003 or later format via email to the JEF Secretariat at elsien@uj.ac.za. Please note that this submission should consist of various separate electronic files: ONE electronic file consisting of all author information (see) only and another separate electronic file consisting of the body of the manuscript.

2. ELECTRONIC DOCUMENT 1: AUTHOR INFORMATION

In this separate electronic document, supply the following details in full for all authors (i.e. including co-authors):

 First name and surname, e.g. Lindi Ngwenya, Carl D Anschutz

 Designation/position, e.g. Senior Lecturer, Professor. (Note that in the case of a student author the level must be specified, i.e. PhD/Doctoral student or Master's student.)

 Programme/department/organisation/institution, e.g. School of Accountancy, University of Pretoria, South Africa; Department of Auditing, University of Nairobi, Kenya.

 Full contact numbers (mobile and landline) and fax numbers and e-mail address.

 Where there is more than one author, highlight the corresponding author's name with an asterisk (*) and email address.

3. ELECTRONIC DOCUMENT 2: MANUSCRIPT BODY

All manuscripts should be submitted in the following sequence: title page, abstract, keywords, text (body of manuscript), and list of references. Please ensure that this document is free of any identification of the author(s) and their affiliation(s).

 Title page: The title page of each manuscript should include the title of the manuscript, limited to 75 characters in length. Titles should be descriptive and summarise the most important point(s) of the manuscript. Should the title be longer than 50 characters, a short title (or running head) of maximum 70 characters also needs to be provided.

 Abstract & keywords: The page following the title page should include (i) the title of the manuscript; (ii) a brief, single paragraph abstract of a maximum of 150 words succinctly describing the article; and (iii) between five to seven keywords. Keywords chosen should capture the essence of the paper as these will be used as an electronic index of the paper. List the keywords in decreasing order below the abstract. Please ensure that abstracts are free of any identification of the author(s), affiliations and acknowledgements. Preferably do not include abbreviations or references in your abstract, unless essential.

 Body: The body of the article should start on a new page following the abstract and keywords.

 List of references: References in the text should appear as explained in section 7. The list of references should be on a separate page at the end of the body of the article and emphasis should be placed on more recent publications. It is the responsibility of the author(s) to verify the accuracy of all references.

4. TABLES AND FIGURES

When referring to figures and tables, each figure and/or table should be mentioned in the text in bold typeface and numbered consecutively.

Each figure should have a unique caption (outside and not inside the text box containing the figure) and should be numbered consecutively in bold typeface, e.g. FIGURE 1: Occupancy rates, 2001.

Tables used should be self-explanatory and concise, and should not duplicate material presented in the text. Tables should include labels and explanatory notes sufficient to permit readers to understand them without reference to the text. Each table should be numbered consecutively in bold typeface, e.g. TABLE 1: Percentage growth in GDP, 2001 – 2005.

All figures and tables should be rendered clearly (in black-and-white only) so as to yield attractive, readable copies.

Acknowledge the source below a table or figure. If created by the author(s), please indicate as such.

When using mathematical expressions (e.g. formulae) in the manuscript, these should be typed exactly as they should appear in print. Mathematical expression should be numbered and these appear in parentheses (bold typeface) flush with the right margin. (Also refer to the section on the layout of manuscripts.)

Maps should contain essential information only and be as clear as possible. Details and features should not be cramped or too small. Use only high resolution *.jpeg or *.tiff files.

5. LENGTH OF MANUSCRIPTS

Manuscripts written in only English should not exceed twenty-five (25) pages, including the abstract and keywords list, tables, figures and references. Manuscripts longer than 25 pages will be returned to the author for revision. In exceptional cases, and at the Managing Editor's discretion, longer articles will be considered if they make an original or major contribution to the field.

6. LAYOUT OF MANUSCRIPTS

 Abbreviations – please keep the use of abbreviations to a minimum. Abbreviations must be explained when they first appear, after which they may be used without an explanation. The normal language rules pertaining to abbreviations apply, but no full stops are used. If an organisation's name appears only once in the document, there is no need to give the abbreviation or acronym.

 Automatic numbering – please do not use any automatic numbering or links. (Also see section headings below.)

 Capital letters – use lower case as far as possible (e.g. parliament, government, state, president, director-general, regional council), except in specific, direct references to specific people. Use lower case for the first letter of a generic ethnic group (e.g. black, white, coloured) but upper case for the first letter of a group named according to country (e.g. African, Indian, Chinese, Swedish).

 Dates – Write dates as 20 July 2005. Not as 20th, 2nd, etc.

 End notes and footnotes – The use of end/footnotes are not permitted and the manuscript will be returned to the author(s) for revision.

 Equations – All mathematical and statistical equations need to be typed using the built-in equation editor in Microsoft® Office Word 2007 or later. Authors should furthermore also note that equation variables referred to in the text should also be set using the same equation editor. Should mathematical or statistical equations be set as ordinary text, the editorial staff of the Journal cannot accept responsibility should any of these be set incorrectly.

 Font – submit manuscripts in 12pt Times New Roman or Arial, 1.5 line spacing.

 Use of bold and italics – Do not use italics, underlining or bold to emphasise points. Rather achieve the required emphasis with an effective style of writing. Note that common Latin and French terms are not italicised. For example: *et al.*, in situ, per capita, inter alia, vis-à-vis, laissez faire. Words and phrases from other languages, e.g. isiZulu, German, are italicised. Please supply a translation of non-English words and phrases and state what language they are, e.g. kgosi (chief, Tswana).

 Headers and footers – manuscripts submitted should not include a running header or footer. To ensure anonymity and facilitate a blind review process, the name of the author(s) should not appear anywhere in the manuscript document.

 Justification – use full justification in manuscripts.

 Lists – Use bullets for lists and not dashes, asterisks or letters of the alphabet.

 Numbers – use a space, not a comma, to indicate tens of thousands etc., e.g. 10 000. Write thousands without a space, e.g. 1000, except in tables, where the space is needed to get the alignment right. For decimals use the decimal point, not comma, e.g. 3.85.

 Page numbers – Page numbers should be inserted at the bottom of each page of the manuscript.

 Paragraphing – Please do not use pre-formatted paragraphing or automatic numbering.

 Percentages – Use the % sign and not 'percent' or 'per cent'. This applies to the text as well as the tables and figures. Use percentages appropriately. If your sample size is small (especially if it is less than 100 items) round off percentages to the nearest whole number. For small data sets, and in a non-technical context, strict mathematical accuracy is not required. In the text, readability is important. Using approximate percentages or even fractions to sum up your findings is therefore acceptable.

 Quote marks – Use single quote marks. Use double quote marks only for quotations within quotations. For long quotations ('long' generally means longer than one sentence), indent the text in a separate paragraph (using a smaller font size) and omit the quote marks.

 Section headings – Number the sections of your paper, beginning with **1. INTRODUCTION.** Please number the sections manually and not with the auto numbering function. All headings are in sentence case, bold (and italics for level-3 headings), and indented by way of tab-spacing e.g.

4. THE VALUE-TO-CUSTOMER FRAMEWORK

4.1 Development of the framework

4.1.1 Elements of the framework

 Spacing between sentences – make a single space after a full stop, not a double space. There should be no more than one space at any point in the document.

 Spelling – please use English UK spelling when preparing manuscripts, for example behaviour, not behavior and organisation, not organization. Please note that in the case of a title of a book or an article or a direct quotation one should "copy" the words exactly as in the original.

 Sources – Cite only sources that are relevant to your discussion. Acknowledge all sources of ideas, statements, tables, graphs, etc. that are not your own. Where you use the exact wording from

a source, you must make this clear by placing the quotation in quote marks or indenting it if it is a long quotation.

7. REFERENCING STYLE

 Add a **list of references** at the end of your article. Note that 'references' means a list of the sources you have actually cited in your article.

 Please ensure that all the sources you cite are listed and that all the sources you list are cited.

 Use the Harvard system of referencing, i.e. citations give the author's name and the year of publication.

 All statements, opinions, conclusions, etc. taken from another author's work should be cited, whether the work is directly quoted, paraphrased or summarised. Direct quotations from publications should be avoided and are only permissible in exceptional circumstances when the specific quotation is so succinct and vivid that the text can be materially enhanced by the quotation.

7.1 In-text citations/references

 References should be inserted in the text by indicating in brackets the name of the author(s) and the year of publication of the quotation, e.g.

... Candy (2005) states that ...

or

... for these purposes (Candy, 2005).

 If reference is made to a specific page (as a result of a quotation), a colon follows the year of publication (no spaces), followed by the page number (again, no spaces), e.g.

... Candy (2005:214) states that ...

or

... for these purposes (Candy, 2005:214).

 If the specific author has more than one publication in any one year, the articles are distinguished alphabetically by inserting the letters a, b, etc. after the year of publication, e.g.

... Candy (2005a:214) states that ...

 In referring to a work by three or more authors, all the relevant names have to be furnished in the first reference to the work in the text, e.g.

... of the authority (Riesman, Denney & Glazer, 2008).

 In later references to this work, only the first author's name is stated, and the abbreviation 'et al.' is used, e.g.

... the modern Western man (Riesman *et al.*, 2008:40).

7.2 List of references

 The reference list is not subdivided into sections for books, journals, papers, etc.

 In the case of articles in academic journals, details of each article should appear in the reference list.

 There are no spaces between the initials of an author should the author have more than one initial.

Below are examples of the most common types of references used:

 Book

Carlton, D.W. & Perloff, J.F. (2005). Modern Industrial Organization, 4th edition. Boston: Addison-Wesley.

Olson, O.J., Guthrie, J. & Humphrey, C. (eds.) (1998). Global Warning: Debating International Developments in New Public Financial Management. Oslo: Cappelen.

 Chapter in a book

Sunley, P. (2003). Urban and Regional Growth. In Sheppard, E. & Barnes, T.J. (eds.) A Companion to Economic Geography. Oxford: Blackwell (pp. 189-201).

 Journal article

Arthur, W.B. (1996). Increasing returns and the new world of business. Harvard Business Review, 74(4), pp. 100-109.

Vandemaele, S.N., Vergauwen, P. & Smits, A.J. (2005). Intellectual capital disclosure in the Netherlands, Sweden and the UK. Journal of Intellectual Capital, 6(3), pp. 417-426.

 Conference paper

Delgado, C.L. & Siamwalla, A. (1997). Diversification in developing countries. Proceedings of the 23rd International Conference of Agricultural Economists, 10-16 August, Sacramento, California.

 Working paper

Helmsing, A.H.J. (1999). Flexible specialisation, clusters and industrial districts and 'second' and 'third generations' regional policies. Institute of Social Studies, The Hague. (Working paper series no. 305).

 Official document

National Department of Agriculture (NDA). (2001). The Strategic Plan for South African Agriculture. Pretoria: Government Printer.

Industrial Development Corporation (IDC). (2001). Industrial development framework. Analytical document. Federal Democratic Republic of Ethiopia. Prepared by IDC for Ministry of Planning and Economic Development. Sandton: Industrial Development Corporation.

 Newspaper or magazine article

Booth, J. (2004). Blair plans annual UK-China summit. Guardian, 11 May, p. 6.

Or, if the author is unknown:

The Economist, 2005. Special report: Congo, Africa's unmended heart, 11–17 June, pp. 5-7.

 Thesis/dissertation

Kleynhans, E.P.J. (2003). The competitive platform for industrial development in South Africa. Unpublished PhD thesis. Potchefstroom: Potchefstroom University.

 Electronic text (Please note that website references must include the date you last accessed the site. This is because websites can change, and even disappear. The date of access certifies that the source was there, in the form you cited, at that particular date.)

Langus, G. & Motta, M. (2007). The effect of antitrust investigations and fines on a firms valuation. European University Institute Florence. [Online] Available: http://www2.dse.unibo.it/mmotta/Papers/FinesFebruary 2007REV.pdf. (Accessed 24 August 2010).

South Africa. (2001). Housing Atlas: Intentions of the Housing Atlas (2001-2002). [Online] Available: http://www.housing.gov.za/content/atlas.htm. (Accessed 25 October 2007).

 For all foreign-language sources, an English translation of a title is needed. This follows the original title and is enclosed in brackets (not parentheses), without italics or quotation marks:

Chu Ching & Long Zhi. (1983). The vicissitudes of the giant panda, Ailuropoda melanoleuca (David). [In Chinese.] Acta Zoologica Sinica, 20(1), pp. 191-200.

Pirumova, N.M. (1977). Zemskoe liberal'noe dvizhenie: Sotsial'nye korni I evoliutsiia do nachala XX veka [The zemstvo liberal movement: Its social roots and evolution to the beginning of the twentieth century]. Moscow: Izdatel'stvo "Nauka."

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ANNEXURE D

LANGUAGE EDITING: PAYMENT ADVICE

NORTH-WEST UNIVERSITY ®
YUNIBESITI YA BOKONE-BOPHIRIMA
NOORDWES-UNIVERSITEIT

Private Bag / Privaatsak X6001, POTCHEFSTROOM
South Africa / Suid Afrika, 2531
VAT nr. / BTW no: 4500209301

PAYMENT ADVICE / BETALINGSADVIES

Payment date / Betaal datum: 07/09/2016
Page / Bladsy: 1 of 1

DIEDERICKS ELSA (ADHOC NO PO)
PO BOX 119

1790

DISBURSEMENT NR. / BETALINGS NO: 962644

INVOICE DATE /	DESCRIPTION / BESKRYWING	INV NR. / FAKT NO.	DEBIT / DEBIET	CREDIT / KREDIET
07/09/2016	PDV: Elsa Diedericks - Language editing			2,580.00

Total amount paid to vendor / Totale bedrag betaal aan verskaffer: 2,580.00

ANNEXURE E

LETTER FROM THE LANGUAGE EDITOR

78 Royal Gallery
12 Skerne Road
Kingston upon Thames
Surrey
KT2 5AD, UK
14 February 2017

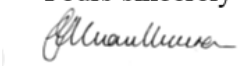
To whom it may concern

Language editing: PhD Ezelda Swanepoel

This serves to advise that, as Ms Swanepoel's PhD promotor, I have proofread the thesis and I am satisfied with the language content.

While I am not a qualified proofreader/language editor, I have, in my capacity as supervisor/referee, reviewed dozens of peer-reviewed articles and many dissertations and theses.

Yours sincerely



Dr Gary van Vuuren

ANNEXURE F

INVOICE FROM THE LANGUAGE EDITOR

INVOICE

Linda Scott

Editing Services

SATI membership number: 1002595

15 Shannon Close
8 The Circus
Three Rivers
VEREENIGING
1929
Phone: (016) 423 5973 or 083 654 4156

Email:
lindascott1984@gmail.com
or
lindas@vut.ac.za

INVOICE NO: 854

DATE : 3 March 2017

TO:

Ezelda Swanepoel
North-West University

FOR: EDITING SERVICES

DESCRIPTION	NO OF PAGES	PER PAGE	TOTAL
Editing Services : Thesis (chapters 1 and 5, acknowledgements, preface, remarks, abstract) entitled *An analysis of reputation- and conduct risk in the international banking: examined through a four point approach*	28	R 25.00	R 700.00
TOTAL DUE			R 700.00

BANKING DETAILS:

Name of Bank	:	ABSA
Account Name	:	L. Scott
Branch	:	Three Rivers
Branch Code	:	632005
Type of Account	:	Savings
Account No.	:	90 6662 9011

Thank you for your business!

Please advise when payment is made to ensure there is no delay in receiving letter of editing.