It takes a lifetime to build, seconds to destroy.
What am I?

A study into how reputation risk management influences Dutch banks' behavior

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By
Robert Tycho Sasja Benjamin Meulenhoff
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Abbreviations

AML/CTF	Anti-money laundering / counter terrorist financing
AMLD	Anti-Money Laundering Directive
CRO	Chief Risk Officer
EC	European Commission
EU	European Union
ERM	Enterprise risk management
FATF	Financial Action Task Force
FDIC	The Federal Deposit Insurance Corporation
FIU	Financial Intelligence Unit
ML/TF	Money laundering and terrorist financing
RBA	Risk-based approach
RRM	Reputational risk management
SDR	Socially desirable response
STRs	Suspicious transaction reports
The Committee	The Basel Committee on Banking Supervision

1. Introduction

In the movie *Stardust*, Captain Shakespeare, played by Robert de Niro, tells Tristian Thorn and Yvaine that he does not want any repayment for his kindness because he does not want to be seen as a kind person. For the Captain, it is all about the preservation of his reputation because "you know reputations, lifetimes to build, seconds to destroy" (Stardust, 2007). Just like for Captain Shakespeare, reputation loss is of real concern to many CEOs: 84% of global senior executives have reported that reputation risk increased significantly between 2000 and 2005. Moreover, the same executives were asked how they would rank 13 types of risk, and reputation risk ranked the highest (Gaines-Ross, 2008; p. 14).

An area that is currently of great concern to financial institutions' reputation is the negative publicity stemming from failing to act appropriately according to the Anti-Money Laundering Directive (AMLD). Over almost two decades, the European Union (EU) has placed more emphasis on its role as an advocate of security (Magdalena Stambøl, 2016), and one of the lingering wars the EU fights concerns money laundering and terrorist financing (ML/TF). With the help of the Financial Action Task Force (FATF), the EU has adopted several AMLDs, which are supposed to protect the integrity of the financial system against ML/TF. The European Commission (EC) has underscored the significance of these Directives by stating the following:

> "[D]irty money has no place in our economy, whether it comes from drug deals, the illegal guns trade or trafficking in human beings. We must make sure that organized crime cannot launder its funds through the banking system or the gambling sector. Our banks should never function as laundromats for mafia money, or enable the funding of terrorists." (EC, 2013)

However, as is clear from many stories in today's newspapers, many banks have failed in their effort to adequately address ML/TF, which has led to both financial and reputation losses. For example, in September of 2018, the Dutch bank ING was fined €775 million because it lacked the tools required to monitor possible suspicious transactions (Openbaar Ministerie, 2018). Due to ING's improper behavior, Dutch lawmakers have tried to displace ING as the government's banker (RTLZ, 2019).

Two weeks after the ING scandal, Estonian investigators discovered that the Estonian branch of Danske Bank had failed to recognize that the vast majority of Estonia's clients performed "suspicious transactions." Although, at the time of writing, it remains unclear what the financial penalty for Danske Bank will be, it has become evident that the public has lost trust in the bank (CNN Business, 2018). These examples show that banks that violate AML legislation can suffer both financial and reputation losses.

In an interview with the Dutch equivalent of the *Financial Times*, the head of the Dutch Financial Crime Unit, Hans Van der Vlist, told the paper that there is a way to measure whether banks act in compliance with Dutch AML legislation. According to the van der Vlist, the public should concentrate on the number of suspicious transaction reports (STRs) that the national Financial Intelligence Unit (FIU) receives (Financieel Dagblad, 2018). Van der Vlist argues that an increase of STRs might suggest that banks indeed live up to the requirements laid out in national AML policy (Financieel Dagblad, 2018). The annual reports of the FIU from 2011 to 2017 show that the sum of STRs by Dutch banks heavily increased in 2017 compared to previous years (see figure 1).

Figure 1: Total number of suspicious transactions reports per year issued by Dutch banks.

Study's goal

This study expects that the increase of STRs has occurred because banks are more aware of reputational loss due to negative coverage stemming from the failure to comply with the AMLD; thus, to show that they are in compliance, they have increased the number of STRs. Therefore, this dissertation examines the following research question and related sub questions:

Research question: *To what extent can Dutch banks' reputational risk management explain their increase in reporting suspicious transactions from 2013 to 2017?*

Sub-questions:
1. Are banks' behavior affected by their reputation?
2. What affects banks' reputation?
3. How does the banking industry handle reputational risks?

The study's central premise

The researcher's central argument is based upon the fact that it is banks' central objective to make money, and because of that, they are inevitably exposed to a variety of risks (e.g., operational, concentration, legal, and reputational risk) (McCormick & Stears, 2018). It thus follows that financial institutions would design and implement an Enterprise Risk Management (ERM), such as a reputation risk management (RRM) program, to protect the organization's reputation, which is a valuable asset. Examples have shown that this asset diminishes when banks are associated with AML scandals. Thus, this study argues that banks alter their behavior to protect their reputation, which consequently leads to an increase of STRs.

The study's methodology

The study's main method of analysis is a content analysis, and to verify the results, the research will also conduct interviews. The ERM literature is used as the basis for both the content analysis and to compile relevant questions for the interviews. For the analysis, the study uses Lessig's conceptual model, which argues that the degree to which actors are aware of four constraints, affects those actors' behavior regarding those constraints. When the sample shows a changing

amount of awareness regarding their reputation, the study will argue that banks have changed their behavior, which consequently leads to increase of STRs.

Study shows that specific characteristics influences the degree to which a company is affected by reputational risk (Heidinger & Gatzert, 2018). To mitigate for these risks, some banks have implemented an RRM program, which is argued to be from significant influence on their awareness regarding reputational risk. Therefore, the study expects that there is a significant relationship between those that have installed an RRM program and some of these characteristics.

It is relevant to examine these hypotheses because it indicates whether the degree to which banks altered their behavior differs. Lessig's conceptual model argues that an actor who is more aware of the constraints imposed on them, affects the chance that the actor will change its behavior. Study shows that banks with an RRM program are more concerned with reputational risk (Heidinger & Gatzert, 2018), making it more likely that those companies have altered their behavior more than those who did not have an RRM program. So, the hypotheses serve as a tool to indicate if banks changed their behavior to a different degree. The reasoning behind these expectations are clarified within the research's methodology in the "hypothesis" section.

Scientific and practical relevance

The study aims to fill a gap in the literature, and it thus has scientific relevance. Gordon (2011) has noted that the literature is far from conclusive on how possible reputational damage influences a business's behavior in the context of complying with AML legislation. This dissertation aims to address that gap.

This research also serves a practical security purpose. Studies in the past have shown that the level of crime is associated with the amount of money being laundered through the financial systems (Ferwerda, 2008), and it is suspected that a significant portion of illegal money is funneled through the Dutch financial system (Europol, 2014). Thus, reducing the amount of ML/TF would diminish the crime rate. Because STRs serve as a tool for authorities to start criminal investigations, a rise of STRs could suggest more ML/TF-related prosecutions, which consequently would lead to less crime. Therefore, finding the root cause that has incentivized banks to issue more STRs, which as a consequence can help lower the crime rate, and can make us as a society safer.

Why reputation risk?

Although many forms of risk may be of interest, this thesis only analyzes how reputational risk may influence banks' behavior. Other forms of risks, such as concentration, operational, and legal risk, were not selected for different reasons. First, when it comes to legal risk, Würtz (2007; p. 46) has argued that there is no clear definition of what precisely legal risk entails. Würtz (2007) continues her argument by discussing how all forms of risk involve some legal component, while at the same time, not all issues with a legal component should be considered a legal risk. The lack of clarity regarding the definition of legal risk makes the research problematic because measuring such risk is more difficult. Due to these problems, the author has chosen to exclude legal risk as a possible influence on banks' behavior.

Although it is clear how operational risk and concentration risk are defined, there is a lack of clarity on how operational and concentration risk influence a financial institution' behavior. This is mainly because organizations have not shown any interest in sharing their policies and procedures on how they address operational and concentration risk (Gordon, 2011; p. 533). First, operational risk is defined as "the losses that may arise from inadequate internal processes" (Gordon, 2011; p. 534). Given that financial institutions are not eager to share information about their internal processes, including how they have implemented the preventive measures as stated in AML regulations, scholars are unable to determine how these forms of risk influence a financial organization's behavior. Thus, analyzing operational risks would make the research unfeasible, and this form of risk has therefore been excluded.

Finally, the literature relating to concentration risk and AML policy is unclear. Concentration risk has been defined as the "excessive exposure to single borrowers or dependence on single depositors" (Gordon, 2011; p. 532). The literature suggests that concentration risk may play a part in a financial institution's behavior concerned with AML policy, but the specific link is not clear. Moreover, it is expected that the banks in this research are unlikely to share the internal policies that determine their concentration risk calculus, which prevents this contribution from moving forward. Therefore, the author has chosen not to include concentration risk as part of this study.

Content

This dissertation is divided into six chapters, including the introduction. The next section, which is the "literature review" holds the conceptualizations of the research's central concepts and theory on the causal mechanisms between the various concepts. The literature review is composed of four chapters, each with its own summary, which describes its significance and relevance for the rest of the dissertation. These summaries help the reader digest the amount of knowledge telling. For the literature review, the researcher uses a snowballing technique, which not only focusses on where papers are referenced but also where papers are cited (Wholin, 2014; p. 1). The journals and the books that the researcher uses, are concerned with ERM, ML/TF and the combination of both topics. The literature review begins with a short history of AML legislation, followed by an explanation of why AML legislation is of interest and why financial institutions are involved in this fight. From there, the review continues with an explanation of ERM and how ERM and AML/CTF are related. The dissertation then presents the research design, which hold the information about the data sample, analysis, and the study's limitations. Next are the study's findings, which shows both the quantitative and qualitative results. The fifth chapter is concerned with the analysis of the findings by using Lessig's conceptual model. The dissertation closes off with a conclusion, which answers the dissertation's central question, discusses its limitation, provides a more in-depth analysis of the findings and finally the researcher offers some recommendations for future research.

2. Literature review

A historical perspective on money laundering and terrorist financing

The term "money laundering" stems from its two English words, and its original was laundering or cleaning money. In the past, bills became dirty because they were used often and needed to be sanitized, so money was laundered. However, "money laundering" now means "the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property, knowing that such property is derived from criminal activity or an act of participation in such an activity" (art. 1 paragraph 3 AMLD 2015/849, 2015). It is estimated that, in 2014, the amount of money being laundered was between $590 billion and $1.5 trillion USD (Basel Committee on Banking Supervision et al., 2014; p. 488).

While it is not known how much money passes through the financial system for terrorist financing, such financing is considered one of the three crucial components for a successful terrorist organization (Ridley, 2012; p. 1). For a terroristic organization such as Al Qaeda, money is first of all used to fund the organization's operations, for example, 9/11 (Ridley, 2012; p. 2). Terrorist financing is defined as:

> "the provision or collection of funds, by any means, directly or indirectly, with the intention that they be used or in the knowledge that they are to be used, in full or in part, in order to carry out any of the offences within the meaning of Articles 1 to 4 of Council Framework Decision 2002/475/JHA" (art. 1 paragraph 5 AMLD 2015/849, 2015)

The necessity of AML legislation

The matter of ML/TF has received global interest for obvious reasons. While society and politicians find it essential that criminals do not profit from their illicit activities, combatting TF is just as important from a security perspective. The argument is that when terrorist have access to fewer funds, they will have fewer means to conduct an attack (Nederlands Compliance Instituut, 2017; p. 21).

The first significant reference to money laundering as a global concern occurred during the 1988 Vienna Convention. The Vienna Convention preceded the G7 summit of 1989, which in turn founded the FATF (Turner & Bainbridge, 2018; p. 215). The FATF is an intergovernmental

institution that has been given the mandate to "prevent the utilization of the banking system and financial institutions for money laundering, and to consider additional preventive efforts in this field, including the adaption of the legal and the regulatory systems to enhance multilateral judicial assistance" (FATF, 1990).

In the 30-plus years after the Vienna convention, with the help of the FATF, ML/TF legislation has evolved extensively both in scope and regulatory measures (Turner & Bainbridge, 2018; p. 216). Initially, the FATF only established recommendations to combat ML; after 9/11, however, the FATF was asked to create procedures to fight TF. The result is that the FATF has issued 49 recommendations in total that serve as the basis for the AMLDs (Nederlands Compliance Instituut, 2017; p. 101). The AMLDs are considered the most severe ML/TF legislation in the region (Bergström, Svedberg, Helgesson & Mörth, 2018; pp. 1049 - 1050).

However, even though the AMLDs are considered the region's strictest measures to combat ML/TF, academics have noted the policy's ineffectiveness (Turner & Bainbridge, 2018; p. 216). Although it is unclear what the criteria is for an "effective AML policy" (Ferwerda & Unger, 2015; p. 121), authors have argued that there is little evidence that "anti-money-laundering policy" has led to reduced money laundering (Gordon, 2011; p. 522). This notion is based on statistics published by the FATF, which suggest that only a small amount of the issued STRs are used to start an investigation (Gordon, 2011; p. 522). Still, the policy's ineffectiveness does not mean that it should be disregarded entirely because AML legislation is a crucial instrument to protect the integrity of the financial sector (AMLD 2015/849, 2015). In order to do so successfully, public and financial institutions have to work together.

The rational for using the private sector's in the war against ML/TF

There are several reasons why the private sector is involved in the fight against ML/TF. The first is because the financial industry has access to relevant data (Gordon, 2011; p. 520). Due to the nature of ML/TF process, it is evident that public authorities face more difficulty in acquiring the relevant data than the industry that owns it. However, the financial industry was not always involved in this fight. Nations were required to develop a global framework of public and private regulations to combat ML/TF due to the globalization of the financial system and the lack of an adequate international regulatory system (Bergström et al., 2011; p. 1046). It is due to this nature of ML/TF that the private sector is involved in this war.

Because of the way how ML/TF works, which is a process that consists of three stages: placement, layering, and integration (Soudijn, 2012; p. 150), the private sector is now involved in this war. The distinguishing mark of the placement stage is that illicit gains are placed within the financial system (such as a deposit in a bank account). The second stage involves the activity where the illegitimate deposits pass through several institutions and jurisdictions, which helps to cover the illegal source of the profits (Baradaran et al., 2014; p. 488). During the final stage of integration, the illicit funds are placed back into the economy, which is done by various forms of financial or commercial operations (Nederlands Compliance Instituut, 2017; p. 29). Because this process runs through the financial system, banks and other private actors are believed to be of great importance to fight ML/TF.

The process wherein the financial sector has now become involved in the fight against ML/TF, has not come without a cost. Due to AML legislation, the private sector is now disproportionately burdened (Turner & Bainbridge, 2018; p. 230). This burden becomes evident when the concepts of risk and securitization are linked with each other. The business activities of the financial industry were originally not linked with securitization; they were a private entity in the business of making a profit. After the financial industry became involved in the fight against ML/TF, it needed a significant amount of resources to accommodate for this new responsibility (Bergström et al., 2011). On the other hand, banks can also use this increased accountability to their advantage. A bank that acts in compliance with the AMLDs may have a more positive association than banks that do not, which suggests the notions of trust, fairness, and transparency (Bovens, 2010; p. 948), but in order to be viewed as such, banks are required to make the necessary investments.

The burden of the AMLD

By installing a five-part mechanism based on the FATF's risk-based approach (RBA), the financial sector should be able to identify suspicious transactions that seem relevant for further investigation by law enforcement agencies. The FATF argues that the RBA is crucial for the AMLD to be effective (2014; p. 3). Implementing an RBA is seen as an attempt to enhance the quality of compliance related obligations to the preventive measures. The RBA must ensure that those who fall under the AMLD do not simply implement a more mechanical form of compliance but try to

prevent illicit funds from passing through the financial system (Mitsilegas & Vavoula, 2016; p. 274) by installing a five-part mechanism.

The first aspect of the five-part mechanism states that financial institutions should conduct a (periodic) review of their entire customer database. This profile serves as a baseline for analysts to determine if the transactions performed by the verified customer seem suspicious. The second requirement obliges financial institutions to keep an up-to-date account of all its customers (Gordon, 2011; pp. 512 – 513). The third requires financial institutions to develop systems and procedures that allow them to monitor all transactions their customers initiate (Gordon, 2011; pp. 515 – 516). When a financial institution discovers a transaction that seems out of the ordinary, bankers are required to investigate this matter, which is the fourth step. When the transaction is indeed found suspicious, the organization is obligated under the final requirement to issue an STR to the nation's FIU (Gordon, 2011; p. 516).

This series of preventive measures is currently required under the fourth AMLD, which was adopted by the EU in 2015. With its implementation, the reach and scope of the measures increased heavily (Turner & Bainbridge, 2018; p. 218) in two respects (Mitsilegas & Vavoula, 2016; p. 273). The first is the expansion of the scope of professions involved that are obligated to install AML preventive duties. Whereas the first AMLD only concerned banks, the fourth AMLD also obligates accountants and lawyers to perform this five-step requirement (Mitsilegas & Vavoula, 2016; p. 273). The second change the fourth AMLD has brought, concerns the amount of detail involved in these preventive duties. The professions that fall under the AMLD are now required to keep a much more detailed account of their clients than was the case under the third AMLD (Mitsilegas & Vavoula, 2016; p. 274). Because the fourth AMLD has increased in scope and the amount of details the private sector needs to record, it raises the burden of the professions to comply with the law (Turner & Bainbridge, 2018; p. 218), but from a security perspective the STRs are a valuable source of information for law enforcement agencies.

The Federal Deposit Insurance Corporation (FDIC) has argued that STRs are of great value in combating ML/TF (2007; p. 24). STRs contain information about the person who conducted the suspicious activity, what instruments were used to facilitate the activity, when and where the activity took place, and argumentation as to why the activity seems suspicious (FDIC, 2007; p. 30). The FIU analyzes the content of the STRs to identify trends and patterns than can be associated with financial crimes. STRs also serve as a mean for law enforcement agencies to generate new

leads, and perhaps open new criminal cases (FDIC, 2007; p. 26). What becomes evident is that the AMLD and the RBA has changed the role of the banks, which were originally more concerned with "traditional" forms of risks.

Summary

As becomes clear, combatting ML/TF has received an increasing amount of attention, which resulted in the founding of the FATF and the 49 recommendations. The recognition of the global threat that ML/TF poses, led governments to create the AMLD, which needs to diminish the amount of ML/TF that goes through our economic system. Due to the nature of the ML/TF process, governments need the aid of the financial sector to combat it. The AMLD directs financial corporations to incorporate a five-step requirement that helps to identify suspicious transactions and help the government locate criminal and terroristic funds.

However, the AMLD does not subscribe how banks and other financial institutions need to implement the 49 recommendations. As a consequence, there may be a discrepancy between banks how they deal with these new obligations. A good indicator to determine how banks deal with this legislation is to examine how the AMLD affects their risk management calculus. When banks recognize the AMLD as a risk, they may want to change their behavior. To determine whether banks change their behavior based on the risk the AMLD is posing, the next section needs to first explain some relevant concepts with regard to enterprise risk management.

Enterprise risk management

Financial institutions such as banks, insurance companies, and credit card issuers are defined by their activities, which can vary from a short-term loan to investment banking. The difference between a private citizen who makes a loan to a relative and a professional organization is that banks are primarily concerned with lending from non-professional clients and "transforming" the funds that have been borrowed into money that is lent to a third party (Theissen, 2013; p. 141). Due to this line of operations, these institutions can make a profit.

However, these business activities also expose banks to various forms of risks (McCormick & Stears, 2018; p. 21). Whether it is an individual or a large corporation, those who face "risk" try to manage its influence, often based on common sense, relevant knowledge, experience, and instinct (Al-Thani & Merna, 2013; p. 8). The concept of risk is usually illustrated with the terms:

uncertainty, probability, effect, and outcome, but not how it is measured. With help of Allen's 1995 framework (see figure 2), it becomes clear how risk can be quantified. By measuring the level of each parameter, a person or firm can determine the chance the risk will occur and how the uncertainty originating from that risk can be diminished (Al-Thani & Merna, 2013; pp. 8 − 11). Allen's model offers an answer as to how much risk there is, as a vehicle for communication, and it exposes the factors that might otherwise be forgotten (Al-Thani & Merna, 2013; p. 11).

Figure 2: Allen's 1995 risk framework with its parameters
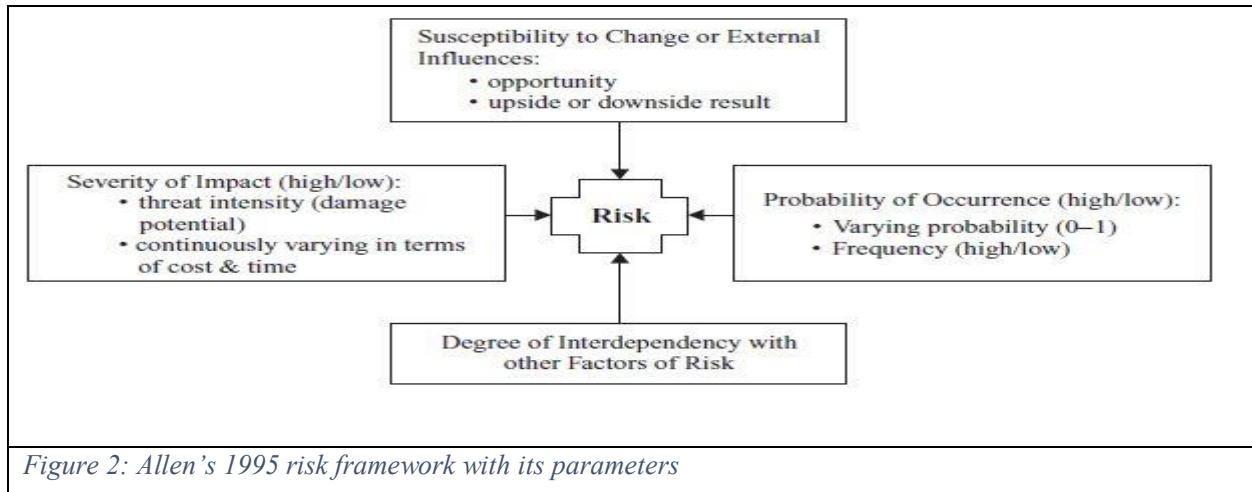
Particularly in the corporate world, where most decisions are based on financial gain, it is highly recommended to understand the risk parameters before a decision is made. Firms need to know the risks involved in an endeavor, the susceptibility, and the possible extent of any adverse consequences that may materialize. Thus, the identification, assessment, and quantification of the risks are of great importance for businesses to determine whether they should start, continue, or terminate a project (Al-Thani & Merna, 2013; p. 11).

In general, there are numerous kinds of risks. One source of risk that is relevant for the industry is any factor that affects business performance (Al-Thani & Merna, 2013; p. 16). The risk may only become visible when its effect is uncertain and significant. Thus, before a company can identify its risks, it needs to know which risks are essential to its corporate and strategic levels.

The Basel Committee on Banking Supervision (the Committee) laid out a three line of defense model that is able to identify, assess, and control the various risks a private organization is exposed to. The model introduced by the Committee in 2011 defines 11 principles for operational risk management (Luburić, 2017; p. 31). It recommends that, for an effective operational risk management, the industry should have three layers of protection: a business line management, an

independent corporate operational risk management function, and an independent audit (Luburić, 2017; p. 31). The first line of defense is the company's department that is concerned with identifying and managing risks. The second line of defense concerns the "risk management function" and needs to be independent of the risk-generating business lines; it is responsible for the design, maintenance, and development of the corporation's risk framework (Luburić, 2017; p. 31). The final line in the Committee's model is an independent review of the firm's controls, processes, and systems, also described as an "internal audit" (Luburić, 2017; p. 31).

The degree to which organizations are exposed to risk differs. Those that are too cautious may find themselves unable to reach their goals, while those that act carelessly may face similar problems (Hillson & Murray-Webster, 2017; p. 17). Therefore, decision-makers need to find a balance between these two poles for the organization's strategy to work. In order to achieve the strategy consistently, it is recommended that decision-makers implement control mechanisms. Control mechanisms are part of an organization's ERM, which generates risk-based data that helps decision-makers determine how much risk is appropriate for the business (Hillson & Murray-Webster, 2017; p. 17). ERM is the practice by which organizations identify, monitor, and limit the risks they are exposed to (Jordão & Sousa, 2010; p. 8). The Committee of Sponsoring Organizations has provided a framework of ERM, defining it as follows:

> "Process, effected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives." (Committee of Sponsoring Organizations, 2004)

Risk appetite and risk attitude

The level of risk an organization exposes itself to depends on its goals and activities. For instance, a nuclear plant wants to avoid as much risk as possible, while banks need to accept some degree of risk in order to make a profit. To control the degree of threats and uncertainty decision-makers face, organizations need to consider their "risk appetite" and "risk attitude." Although there is no consensus on a definition for the former, this has not prevented scholars, risk bodies, regulators, or consultancy firms from making "risk appetite" a topic of significant interest (Hillson & Murray-Webster, 2017; p. 27). Hilson and Murray (2017; pp. 28 – 30) have explained that, because various

institutions such as the European Commission, the International Organization for Standardization, and KPMG all use a different definition of risk appetite, there is confusion as to what the concept means, how it should be used, and how it relates to other risk terms such as "risk attitude." The common theme that arises when organizations explain risk appetite is that they all consider it as related to an amount of risk and as a willingness to accept an amount of risk (Hilson & Murray, 2017; p. 34).

However, when Hilson and Murray (2017; pp. 35 – 36) have detailed the differences between risk appetite and risk attitude, it becomes clear that risk appetite is influenced by external factors, which influence the amount of risk an organization wants to take. Risk attitude, on the other hand, points to an organization's choice on the spectrum from "risk averse" to "risk-seeking." The two concepts are not synonyms, but they do share a vital similarity, which can explain why they are often confused. Both concepts exist within people and organizations, which is why it is difficult to measure or determine their appetite or attitude. The feature that is crucial for understanding how the two differ is that attitude can be chosen, while appetite "just is what it is" (Hilson & Murray; 2017; p. 36).

Three factors influence an organization's choice of where it stands on this "risk continuum": conscious factors, unconscious factors, and affective factors (Hilson & Murray; 2017; p. 38). Conscious factors include aspects that are measurable during a risky situation, and unconscious factors are forms of cognitive biases or mental shortcuts that people acquire from experience. Finally, affective factors include feelings, such as fear, that allow decision-makers to make a more rational assessment of the situation (Hilson & Murray; 2017; p. 38).

The relationship between AML/CTF and ERM is that it is all based on controlling risks, which depends on the industry's risk appetite, and risk attitude, all coming together in the FATF's recommended RBA.

Risk management and AML/CTF

An RBA to AML means that banks should be able to identify, measure, and understand the ML/TF risks to which they are exposed. The RBA helps banks with the implementation of a risk-sensitive application of AML/CTF measures (FATF, 2014; p. 10), but the lengths to which a bank should go to control for these kinds of risks is not stated, which is also apparent in recommendation 15 of the FATF, which is described in more detail later on in the study. Thus, banks have the discretion

to determine how much of a risk they are willing to accept, which should be in line with their risk appetite.

It logically follows that the financial industry tries to invest as little as possible in its policing measures in order to maximize profits. When banks no longer regard additional measures as beneficial for their activities, they will not spend any further funds on this securitization process, which may hurt the goal of the AML policy (Gordon, 2011; p. 529). A factor that may persuade a bank to spend more on its arsenal of policing measures is when a private entity is directly affected by criminal activity or when the public sector does not adequately address the malicious activity (Gordon, 2011; pp. 529–532). Still, this is not the case with ML/TF; related funds do run through the financial system, but this does not directly hurt the company, only indirectly, after, for example, sanctions are imposed on the bank, which hurts its reputation. ML/TF is thus a risk for the value of the company, which is why banks may choose to bear the expenses that derive from reputational risk (Gordon, 2011; p. 532).

Summary

Enterprise risk management is part of the business to protect it against risks. When the amount of risk is not in line with the business' risk appetite, they change their risk attitude. So, this section has explained the basic concepts of risk management, which is important because of the argument this dissertation is trying to make. In conjunction with the previous section, banks may possibly change the risk attitude due to the threat the AMLD is posing for its businesses. An asset that financial corporations aims to protect is their reputation, which may be adversely affected when it does not comply with the obligations of the AMLD. The next section explains the concept of reputation and how it is influenced within the universe of the corporate world.

Reputation

Reputation is considered a behavioral concept that reflects what someone does (Honey, 2013; p. 10), and it is of high value to attract new customers, investors, and employees. A good reputation benefits a company for multiple reasons. First, it allows the company to generate more sales. Second, it allows the organization to grow by recommending or buying its stock, and among many other positive aspects, a good reputation convinces the public that the company behaves ethically (Gaines-Ross 2008; pp. 6–7). However, because reputation is an intangible asset, scholars cannot

determine to what degree it contributes to future revenue or the corporation's market share (Gaines-Ross, 2008; p. 24; Honey, 2009; p. 11; Honey, 2013; p. 11). Still, because reputation is commonly associated with damage, scholars such as Honey (2009; p. 8) have underscored that when reputation is linked with a person, place, or organization, businesses' value can accidentally be negatively affected by adverse events.

According to Honey (2013; p. 10), six aspects must be understood in order to understand reputation: the relational construct, the exception attributed, perception comparison, unintended consequences, track record, and the emotional appeal. Relational constructs point to the importance of maintaining a good relationship between businesses, with their shareholders, investors, and consumers. The confidence that stems from these parties reflects the market capitalization and share price (Honey, 2009; p. 8). Second, "exception attributed" is a tool that stakeholders use to differentiate between competitors and peers in order to make comparisons, which can hurt or positively affect their reputation (Honey, 2013; p. 11). Third, "perception comparison" is based on stakeholders' perceptions, which are established on experience, knowledge, and belief. Although a corporation can influence stakeholders' experience and knowledge, it has little chance of changing stakeholders' beliefs. When a corporation is believed to be linked with criminal activity, the organization has little power to change that perception (Honey, 2009; p. 9). Fourth, the law of "unintended consequences" states that reputation damage is never intentional, but always consequential (Honey, 2013; p. 10). Fifth, the "track record" refers to the understanding that a reputation is built over time, and that building a good reputation is, therefore, a long-term process based upon what one does rather than says (Honey, 2013; p. 10).

Finally, reputation is based on emotions such as trust. Trust is argued to be a critical factor for an institution's reputation because the public is considered an economic force. When the public loses trust, the organization can be heavily damaged (Gaines-Ross, 2008; p. 22). On the other hand, when people have more trust in an organization, they are also more inclined to invest in it (Honey, 2013; p. 10). Therefore, "a good reputation is also a valuable endorsement of trust" (Honey, 2009; p. 10), but because reputation remains an intangible asset that is difficult to measure, protecting an organization's from reputational risk is one of the most relevant and difficult tasks of a risk manager (Gatzert, 2015; pp. 485 – 486).

Reputational risk

The definition of "reputational risk" involves an organization that behaves in a way that falls short of the stakeholders' expectations (Honey, 2013; p. 11). In other words, there is a gap between what is expected of the organization and what the organization does. Risk management tries to minimize or close this gap in order to protect the corporation's reputation value. However, because stakeholders' expectations tend to increase over time due to media exposure, market knowledge, and competitor claims, risk managers find it difficult to protect the organization from this growing demand (Honey, 2009; p. 13). Therefore, reputation risk management is a form of "expectation management." Effective expectation management tries to align the increasing demands of stakeholders with businesses' performance in order to maintain the value of their reputation (Honey, 2009; p. 14).

The damage of reputation loss is calculated by adding the loss of trust to the expenses incurred by regaining that level of trust (Honey, 2009; p. 14). The severity of the damage is affected by the quality of the reputation before the incident, the cause of the incident, and how the incident was handled (Honey, 2009; p. 14). It is likely that an incident will cause little damage if the quality of the corporation's reputation was high before the incident, if the incident was caused without any wrongdoing by the organization, and if the response was adequate. Therefore, reputation risk is defined as "a risk to value in a relationship of trust, where the cost of the risk is the cost of the recovering lost trust" (Honey, 2009; p. 15).

In handling reputation risk, corporations have the choice to avoid, manage, or mitigate it (Honey, 2013; p. 23). Most risk managers see their job as preventing any damage that may be imposed on the business by avoiding cost damage liability. An example of avoiding risk is safety regulations in the workplace, which create a common-sense personal safety zone (Honey, 2009; p. 17). Second, risk managers try to "manage" the risks that are part of the organization's business activities. For instance, banks fund projects that they believe will be profitable. However, when a bank invests in a project such as the Dakota pipeline, it may face negative media coverage, which can cause shareholders to lose faith in the business. Third, when risks lie outside the control of the organization, risk managers' strategy is to reduce or mitigate the negative consequences in order to protect the trust of the organization (Honey, 2009; p. 17).

Reputational risk is part of banks' ERM and is commonly influenced by situations that can adversely affect its value. On the other hand, reputational risk can also act as an advantage from a competitive standpoint (Gatzert, 2015; p. 486). In the event an organization improves its reputation, the value is enhanced. However, stakeholders rarely consider reputation risk as a "opportunity" or as "chance"; they regard reputation in this sense more as a "stroke of luck" (Honey, 2009; p. 13). So, reputational risk is more often considered to be a risk that can cause value reduction, such as in the case of failing to comply with the AMLD, than a risk causing value increment (Honey, 2009; p. 13),

Reputational risk and AML/CTF

The Committee has emphasized that banks should be aware of the reputational risks that derive from AML legislation. According to the Committee, it is in the best interest of the banking industry to comply with AML legislation because those who do so can benefit from more public confidence and a higher share price (The Basel Committee on Banking Supervision, 1998). Moreover, scholars have argued that banks that face negative publicity concerned with AML will be associated with criminals, which can consequently undermine the public's confidence and result in a loss of trust and even a decline in the businesses' share price (Sharman, 2011; p. 47).

Still, it has been difficult for scholars to establish whether a bank's reputational risk calculus is affected by AML policy (Gordon, 2011; p. 533). These difficulties arise from the fact that several empirical studies on reputational risk have focused on the relationship between reputational damage and financial effects (see De la Fuente Sabaté & De Quevedo Puente, 2003). Interestingly, preliminary studies started in 2003 by Professors Michael Levi and Peter Reuter have determined that the stock price of a private entity does not change based on money laundering stories (Gordon, 2011; p. 533). However, it must be noted that the scholars lack an actual definition of what is considered a "change." Still, resrach shows that the financial sector is indeed aware of its reputation.

Reputation awareness

As the study of Heidinger and Gatzert (2018) has shown, financial institutions both in the United States and Europe have become increasingly aware of their reputation and reputational risks. In the wake of the financial crisis, the role of the Chief Risk Officer (CRO) has started focusing more on

reputational risk instead of the traditional sources of risk (Deloitte, 2014; p. 7). Thus, banks have granted their CROs more stature, authority, and independence than before, and the CRO has become more involved in the decision-making process, which has also caused their departments to grow and become better qualified to work with the business side of the firm and its regulators (E&Y, 2013; p. 29).

The stronger position of the CRO is evidenced by the results that show that financial organizations on the North American and European continent are concerned with their reputation and have committed to considering reputational risk as an essential part of risk management. This finding is not surprising; the Economist Intelligence Unit held a survey in 2005 with 269 senior risk managers and found that reputation was even then considered one of the corporate world's most important assets (Economist Intelligence Unit, 2005; p. 2). According to the report, the most important asset companies need to protect in today's capitalist economy is not its revenue, its real estate, or other tangible assets; rather, it is trust. A professor of finance at the SDM Institute in India has even suggested "that without a reputation, you have no business" (Economist Intelligence Unit, 2005; p. 6).

Therefore, it is more than logical that Heidinger and Gatzert's study, and industry surveys have found that corporations have started focusing more on the benefits and negative consequences that reputation and reputational risk may pose (E&Y, 2013; Deloitte, 2014). Reputational issues have become more of a concern because a company's reputation is a source of competitive advantage. Risk managers also regard regulators' position as an important reason to focus more on reputational risk, and also because customers can now more easily switch between suppliers (Economist Intelligence Unit; 2005; p. 5). Thus, it is imperative that a corporation's risk manager is aware of the expectation's stakeholders have to control the risks that endanger the value of the business's reputation.

According to most senior risk managers, the largest risk to a company's reputation comes from compliance risk, which is when the business fails to meet regulatory or legal obligations (Economist Intelligence Unit, 2005; p. 2). Risk managers also need to be aware that "although you may be doing everything right, but if people don't think do, you still have a problem, which is why the public perception can be of a great impact" to the business reputation (Economist Intelligence Unit, 2005; p. 12).

The measurement of reputational risk is possibly difficult due to the nature of "reputation" as an intangible asset, and thus any valuation of its worth is always an estimate (Honey, 2013, p. 25). Although companies spend many resources to measure their external perception, to track reputational threats, and to train the staff to identify and manage reputational risk (Economist Intelligence Unit, 2005; p. 20), it remains a struggle to measure a less-quantifiable asset such as reputational risk (E&Y, 2013; p. 20).

Summary

As has been explained in this section, reputation is an important intangible asset that risk managers found hard to protect. The variety of factors that affect the reputation of the businesses, which cannot all be influenced by the institution itself, make it difficult to determine how much risk a corporation runs. Over the last 15 years it has become clear that the businesses became more aware of its reputation and its relevance to protect it. Hence, by applying one of the risk handling strategies of "avoidance", "mitigation" or "managing", risk managers are trying to protect the corporation's reputation.

The section has also described that acting in compliance with the AMLD can give a corporation a competitive edge over others with respect to reputation. However, because reputation is as a concept hard to measure, it is difficult to determine whether banks have changed their behavior because they want to protect their reputation because of the negative consequences the AMLD may bring. Fortunately, Lessig's conceptual model offers a valid method to determine whether banks changed their behavior due to the risks the AMLD poses for their reputation.

Awareness leads to behavioral change

Quantifying the reputational risk for a company can therefore be a difficult process, as is the process of identifying how much of a buffer the industry needs to know whether it runs any risk. Fortunately, a scholar argues that the degree to which an actor is aware of certain modalities, can alter its behavior. Lessig's conceptual model argues that the four modalities of "social norms," "law," "markets," and "architecture" shape our behavior. These regulators or "codes" (2006; p. 121) are distinct and interdependent, meaning that one form of constraint can either support or oppose another.

According to Lessig (2006; p. 122), social norms do not need to depend on the law to be punishable, nor are they influenced by price, quality, or technology; they are instead a constraint imposed by the community upon an actor who behaves in a deviant manner (Lessig, 2006; p. 122). It is not always clear what counts as a constraint because social norms are not static; rather, they change because they are considered social constructs (Engert, 2002). Thus, the kind of social norms Lessig has discussed are "normative constraints" sometimes backed by sanctions from the community (Lessig, 2006; p. 340). Abnormal behavior can create a base for the community to impose sanctions on the deviant, but only after the actor has violated the social norm. Thus, sanctions are only imposed upon the actor after the atypical behavior has occurred (Lessig, 2006; p. 341).

The modality of markets regulates behavior through pricing structures. This means that an actor can be denied access based on the charges required to participate (Lessig, 2006; p. 124). Furthermore, the constraints of the market can be influenced by law, as in the case of taxes. A law that imposes taxes on commodities will consequently increase their price, making it more difficult for customers to acquire the product (Lessig, 2006; p. 127). Therefore, the constraint of the market is imposed before the action itself, which is not the case with the modalities of social norms and law.

The final modality Lessig discusses is "architecture" (Lessig, 2006; p. 124), which points to the design of a commodity or product. The design of a commodity restricts or allows actors to use it for that purpose. In other words, the way a product is designed constrains an actor before the product is used.

Finally, Lessig divides the four modalities into either the "objective perspective" or the "subjective perspective" categories (Lessig, 2006; p. 343). The former refers to the moment a constraint is imposed on the actor (Lessig, 2006; p. 343). Thus, while the modalities of "social norms" and "law" penalize an actor after the deviant behavior has occurred, the modalities of "markets" and "architecture" constrain an actor before an action. The subjective perspective, on the other hand, relates to the degree to which the actor feels influenced by the code. For both the modalities of social norms and the law, the actor needs to be aware of "social norms" and "law" to be affected by them. Awareness in this instance positively affects the code's effectiveness. Lessig has argued that the degree to which an actor feels constrained by "social norms" and "law" depends on the subjective perspective (Lessig, 2006, p. 344).

Summary

The final section explained the conceptual model of Lessig, which describes how behavior is affected by external factors that allow or deny us certain actions, therefore, bounding our ability to act. The AMLD is in this regard considered an external factor that may altered the behavior of banks. The next chapter describes the input that this dissertation will collect that serves as the input for the final analysis which.

3. Research design

In this empirical research, the author aims to determine to what degree the increase of STRs can be attributed to banks' change in reputation awareness because of the compliance risk the AMLD raises. In order to make this study both valid and reliable, the researcher has chosen to divide the design into two parts.

In the first and main part of this study's methodology, a content analysis on the banks' annual reports is performed. The author has chosen a content analysis because it is a useful scientific method to determine whether beliefs and values influence the way actors behave (Coffey, 2005, p. 100). The second part of this study, which concerns interviews, serves as a verification of the findings derived from the content analysis. The interviews are a necessary tool to determine if the constraint that the banks feels subjected to, actually leads to a change in behavior because studies have shown that more awareness or knowledge does not automatically lead to a behavioral change (WRR, 2017). So, the interviews are necessary to establish whether the results of the content analysis are valid. This study thus uses a mixed-methods approach, which scholars have recommended (Bennett & George, 2005). Given that both research methods are used, this study can find a causal mechanism in the real world while verifying the results (Makady et al., 2017). Because this research aims to find a causal mechanism between reputation(al) risk awareness and the increase of STRs, this method is necessary to come to reach a valid conclusion.

Case selection

Content analysis

The content analysis uses the annual reports of the 13 largest banks operating under the same banking license issued by the Dutch Central Bank. While many more banks operate in the Netherlands, these 13 (ABN Amro, Achmea, Aegon, BNG, Delta Lloyd bank, ING, Nationale Nederlanden, NIBC, NWB, Rabobank, Triodos, Van Lanschot, and the Volksbank) cover more than 98% of all banking activities in the Netherlands, and are therefore argued to be a representative population for the amount of reputation awareness within the Dutch banking industry. Hereafter, when this research discusses "banks," it refers to those included in the research's sample. Although these institutions are not identical in terms of the services they provide, the most important similarity for this research is that they operate under the same banking license, which consequently

exposes them to the same kinds of expectations from consumers, the media, regulators, and other shareholders (Tweede Kamer, 2018). Due to this characteristic, the author has confidence that the conclusions from this part of the analysis will be valid.

Interviews

The interviews for this study are held with (former) employees who are or were part of banks' ERM department. The researcher approached the respondents through three means, first using his own network to contact the relevant professionals. The second method the researcher used is the messaging app of LinkedIn, whose search feature allowed the researcher to find the appropriate experts. Third, the researcher sent e-mails to public e-mail addresses that banks use for their communication with (potential) clients. The scholar sent those persons and departments of interest, information about the nature, duration, and purpose of the prospective interviews. A format of the letter is found in Appendix A. By holding interviews with banks' risk personnel, the researcher could verify the results from the content analysis and strengthen the research's validity.

Method of data collection

Content analysis

The content analysis of this dissertation is based on the study conducted by Heidinger and Gatzert (2018), which used the annual reports of banks and insurance companies from Europe and the U.S. to determine whether these organizations showed an increasing interest in their reputation and RRM. By conducting a textual analysis, the scholars determined that the awareness of reputation-based risk tripled between 2006 and 2015. Moreover, Heidinger and Gatzert's study found that banks' annual reports hold information about topics concerned with reputation risk and its management (2018, p. 108). Because this study is also interested in the development of financial institutions' reputation awareness, the researcher copies parts of Heidinger and Gatzert's study methodology.

However, the difference between the two studies is that the scholars' research focusses on the development of RRM programs of financial institutions on two separate continents, while this study aims to determine whether Dutch banks show a changing amount of awareness considering reputation and reputational risks. Moreover, Heidinger and Gatzert's study is descriptive by nature, while this research is explanatory. Still, the research uses as did Heidinger and Gatzert annual

reports because the meaning of annual reports is that they serve as public relationship documents that allow other actors such as the media, citizens, government, and regulators to keep track of the banks' business activities (Dragsted, 2014; p. 85; art. 2:391 lid 1 BW). Moreover, the information within these documents shows the expected course of the company, which also informs the stakeholders about the risks it expects and how it handles them.

Interviews

The study aims to interview a risk-manager or a risk employee from each bank. That employee needs to be part of the bank's enterprise risk management program. It is vital that the researcher tries to conduct as many interviews with risk personnel of different banks as possible because that will strengthen the validity of this research.

The research uses semi-structured interviews to ask experts relevant questions. This part of the research consists of purposive sampling, suggesting that these interviewees are a representation of the population and potentially offer the best relevant data that is of interest to the researcher (O'Keeffe et al., 2016: p. 1913). The benefit of the semi-structured interviews is that the researcher can interrupt, summarize, verify, and probe the answers provided (Ritchie & Lewis, 2003). Before conducting the interview, the interviewees received a document with information about the specifics of the interview (see Appendix A). The first paragraph of the document describes the background of this research, why this study is conducted, and what this thesis hopes to achieve. The second paragraph of the document explains why the interviewees' contribution is necessary for this research. Finally, the researcher explained how the information retrieved from the interviewees would be analyzed.

By conducting these interviews, the researcher is able to verify whether the image presented in the annual reports was a valid representation of the reality. The interviews are also necessary to obtain a more detailed account of the inner workings of the banks and other complex issues (Bowling, 2002; p. 260). Finally, the interviewer did not plan to inform the experts about the questions beforehand but would deviate from this process if it could convince interviewees to participate.

Data analysis

Content analysis

As mentioned above, this research performs a content analysis of 13 banks over a five-year period. The terms that this study examines are derived from Heidinger and Gatzert's (2018) study and ERM (see Hoyt and Liebenberg, 2011; Beasley, Clune & Hermanson, 2005; Liebenberg and Hoyt, 2003; Pagach and Warr, 2011; Gordon et al., 2009). These terms are predetermined according to a predefined dictionary (see Appendix B). As in Heidinger and Gatzert's (2018) study, this content analysis also focuses on the frequency of specific terms that are recorded in the dictionary, as is common in textual analysis.

This part of the content analysis highlights words. The number of times a word such as "reputation" occurred in an annual report was recorded. When the content of the report does not refer to an indicator, it is not used for analysis. Words that are a description of the indicators are not considered in this analysis. If an indicator occurs more than once in a sentence, the same number of references is used for the analysis. The researcher divided the terms in two categories, reputation and reputation(al) risk. The sum of the examined terms specifies how aware the bank is of "reputation" and "reputation(al) risk" because, like in Heidinger and Gatzert's (2018) study, the number of times an annual report refers to these terms is considered a proxy for the bank's awareness regarding its reputation.

The second part of the content analysis focuses on sentences. In the annual reports, reputation is linked to other kinds of risks such as compliance, integrity, and fraud. The researcher has chosen to include these words because the AML is a law that is by nature a compliance risk, which is why the word "compliance" is included in this part of the analysis. The AML is also concerned with protecting the integrity of the financial sector both internally (bribery) and externally (the whole financial system). Finally, the term "fraud" is also included because money laundering can originate with fiscal fraud.

If the content of the annual report shows one of the indicators recorded in Appendix C, the researcher determines whether the indicator is linked with risk related to compliance, integrity, or fraud. If the content of the annual reports shows that there is a link with any of these risks, two sentences are highlighted: the sentence in which the indicator is mentioned, and another sentence prior to or following the sentence with the indicator. The researcher chose the sentence that

provides the most context in relation to the sentence with the indicator. If the frequency of the indicator is greater than one and within the length of two sentences, the researcher counted that result singularly. A quick analysis of the datasets indicates that the main area that concerns a bank's risk management program is situated in the risk management section of the annual reports. However, banks may also refer to their reputation in other parts of the reports, which is why the content analysis scrutinizes the entire report.

Given that this content analysis uses a mixed-methods approach, both quantitative and qualitative results are reported. The researcher is, therefore, able to show not only whether the sample has become increasingly aware of its reputation and reputational risk but also whether banks have become more aware of the link between reputation and compliance, integrity, and fraud. Both results are relevant for the final analysis because they are considered as necessary input for the analysis.

Analyses strategy

The analyses in this dissertation depends for a big portion on its statistical analyses. Therefore, each paragraph within the section "results" will follow a step by step process. This process will assure that the statistical analyses part of this study is clear and complete.

The study uses a t-test to determine whether the results in regard to the hypothesis are significantly different. However, because the sample is not large enough to assume the central limit theorem, the researcher is forced to conduct a F-test first for every hypothesis. After an introduction of the results, the researcher shows both the critical F value, and the F value. If the F-value is below the critical region, a t-test with equal variances is conducted. The study executes a t-test with unequal variances when the F-value lays outside the critical region. A one-sided p-value is given because as is shown in the next section, the hypotheses expects that the results go a single direction. Then the paragraph end whether the p-value is significant and whether the H_0 is rejected or confirmed.

Hypotheses

The study of Heidinger and Gatzert (2018) found that firms with an implemented RRM program are more aware of their reputation than those without such a program. Because this study uses "awareness" as an independent variable for its final analysis, it is necessary that the determinants

that are from interest to the case of AMLD are examined. The argument is that banks with an RRM are more inclined to change their behavior than banks without an RRM, because they are argued to be more aware of the constraint imposed on them.

This study partly replicates their research, to verify the results of Heidinger and Gatzert (2018). The determinants that this research verifies are size, reputation awareness, and risk awareness. This research adds one other determinant of interest, which is compliance, integrity, and fraud (CIF). Thus, this research analyzes whether there is a significant difference between banks with and without an RRM based on size, reputation awareness, risk awareness, and CIF.

Size: First, scholars have found that banks differ in the degree to which they are affected by reputation damages (see: Fiordelisi, Soana & Schwizer, 2013). Fiordelisi et al. (2013; p. 1367) have found that a bank's reputational damage is positively affected by its size. Organizations that are greater in size are more profitable and of greater public interest, and they thus face more reputational risks (Heidinger & Gatzert's, 2018; p. 109). Therefore, larger banks are exposed to more risks, and because reputation risk is considered the "risks of risks" (see, e.g., Gatzert and Schmit, 2016; Economist Intelligence Unit, 2005), larger banks are more likely to have implemented an RRM program. In this research, *size* is defined as the natural logarithm of the total assets registered in the annual reports. This brings us to the first hypothesis:

H$_1$: *Larger banks are more likely to have installed a reputational risk management program than smaller banks.*

Reputation awareness: The study summarizes the frequency of the terms "reputation" and "reputational risk" in the content analysis in the annual reports as a proxy for the firm's reputation(al) risk awareness. Heidinger and Gatzert (2018) have reported that the frequency of terms positively affects the likelihood that a firm has an RRM program installed because they are considered to be more reputation(al) risk-aware than those banks who do not. This study will verify their results, leading to the following expectation:

H$_2$: *More reputation(al) risk-aware banks are more likely to have implemented a reputational risk management program than banks that are less reputation(al) risk aware.*

Risk awareness: The sum of the term "risk" indicates how aware a bank is of risks, and as in Heidinger and Gatzert (2018) at the start of their study, it is expected that companies that are more risk-aware are also more likely to have an RRM implemented. However, contrary to what Heidinger and Gatzert (2018) expected, banks that were more risk aware were less likely to have an RRM implemented. A possible explanation for this unexpected finding is that banks consider reputational risk to be "a secondary risk and thus should not be managed separately" (Heidinger & Gatzert, 2018; p. 115). Therefore, the study expects to find that:

H$_3$: *Banks that are more risk-aware are less likely to have a reputational risk management program than banks that are less risk-aware.*

CIF: At the time of writing this dissertation, the financial industry has become more intensively regulated, which increases its burden to comply with the law. Firms need to increase their investments to stay up to date on regulations in order to avoid the failure to comply, also known as "compliance risk." The sum of instances in which the annual reports link reputation or reputation(al) risk to compliance, integrity, or fraud is considered a proxy for the sample's awareness of these risks. The literature shows that banks' reputation is negatively affected by the failure to comply with regulations, or when the firm is linked with integrity- and fraud-related issues. It is, therefore, expected that:

H$_4$: *Banks that refer more to reputation in relation to compliance-, integrity-, or fraud-related issues are more likely to implement a reputational risk management program than banks that refer less to reputation linked to compliance-, integrity-, or fraud-related concerns.*

Interviews

The list of questions for the interviewees aims to verify the results of the annual reports and to provide the study with the necessary information for the final analysis. The data collected from the interviews was systematically analyzed by reviewing the transcripts, which was done separately from this research's quantitative part. Because the interviews also serve as a tool to verify whether the results of the content analysis are accurate, some of the questions are based on the quantitative

part of this research. However, the data from the participants is also used to create a narrative through inductive coding. The inductive approach suggests that the codes derived from the interviewees serve as a starting point for further analysis (van Staa & Evers, 2010: pp. 9-10).

Final analysis

The results of the findings, which are both qualitative and quantitative, serve as the input for the study's analysis. It is the study's goal to determine whether the sample's awareness of reputation has grown, consequently leading to a change in the banks' business operations. Using Lessig's conceptual model as described in his book *Code 2.0*, the study examines if the change in the sample's reputation awareness and risk management has led to a changing amount of burden to which the industry feels subjected to. Lessig has explained how the four modalities constrain an actor's behavior both in the online and offline worlds (2006; p. 125). The study operationalizes this knowledge in the following way.

First, social norms are a relevant factor in this study's analysis because it has been argued that they are social constructs that stipulate how an actor should behave. Thus, social constructs contain an expectation that the actor will act according to the code imposed by the community. Reputation risk management is concerned with the expectations of stakeholders. One of the responsibilities a risk manager has is to align the business operations with the expectations of the stakeholders in order to protect the reputation. If the sample shows a change in its awareness with regard to different stakeholders' expectations, the study argues that the banks' behavior has changed.

The modality of law constrains an actor's behavior through ex-post sanctioning (Lessig, 2006; p. 124). A sovereign or government establishes laws that actors should follow. If they fail to do so, they face a penalty (Lessig, 2006; p. 340). Ignorance of the law can be a problem if a bank has no in-house lawyer, which is not often the case. Still, problems can arise when a bank does not consult with its legal team about what the law requires them to do, which consequently may lead to various risks (McCormick & Stears, 2018; p. 425). This modality is analyzed with the results that show whether in-house lawyers are more or less often consulted in the business process and whether banks have become more aware of compliance, integrity and fraud related concerns. In addition, if the results show that the compliance departments have changed with respect to numbers, budget, or in other ways, the study argues that the actor has become less ignorant of the

law. When the actor is more aware of this risk, the study argues that banks feel more constrained by the law, which could lead to behavioral change that handles the sources of reputational risks more.

The study uses the modality of markets by considering "protecting reputation" as the product the sample wants to acquire. When the findings show that there is a change in the amount of resources a bank has invested in the protection of its reputation, the study argues that the banking industry has changed its behavior.

In this study, the modality of architecture is operationalized by examining the kind of system the banks use to execute their five-step requirement. Under recommendation 15 of the FATF, banks are allowed to develop their own systems to monitor their transactions and find possible suspicious activities. The system that performs the analysis of all transactions is here referred to as the "architecture." When the study finds evidence that a sample has altered its systems, the analysis argues that banks have changed their overall capability to comply with the obligations in the AMLD and lowered the risks stemming from failure to comply with regulations.

Finally, this study uses Lessig's "objective" and "subjective" perspectives to determine which of the modalities has caused the alteration in the sample's behavior, allowing the researcher to determine the root cause. As was stated in the beginning of the literature review, banks aim to increase their profit by controlling the risks that stem from their business activities. The risks the banking industry faces in the case of the AMLD comes from either the modality of law or social norms, but not from markets or architecture.

The study expects that the sample only invests in the modality of markets or architecture to control the risks that come from the modalities of law and social norms. It is not in the interest of banks to invest in the budget of their RRM programs or systems when doing so does not help the industry save money. Firms only invest in these mechanisms if they believe it helps them control for the risks that may diminish their profit, which are either the risk of failing to comply with the law or falling short of the stakeholders' expectations. In order to determine which modality is of greatest concern to the industry, the classification of objective and subjective perspectives is necessary.

Limitations of the research design

In order to strengthen the validity and reliability of this study, the researcher took the following appropriate measures. First, because this research uses the method of content analysis, which is a research method to measure variables as they naturally occur, its validity becomes questionable (Neuendorf, & Skalski, 2002; p. 49). The content analyses aim to answer the research questions by studying annual reports, which are texts that have no single meaning. A text is written to have meaning for those who read it (Krippendorff, 2004; p. 19), who can then interpret it in different ways depending on their perspective (Krippendorff, 2004; p. 22). Therefore, in order to enhance its validity, it is vital that the researcher addresses how the text has meaning (Krippendorff, 2004; p. 24).

Concerning the validity of the qualitative part of this research, two main points need to be addressed. First, due to the sensitivity of the information the interviewee presents, it is wise to assume that candidates provide socially desirable responses (SDRs). SDRs are answers that are not true but make those questioned appear in a positive light (Steenkamp, De Jong, & Baumgartner, 2010; p. 199). It is important to highlight this issue because, due to the nature of this research, it may be logical to assume that candidates may not answer the question truthfully due to their employment status. In order to reduce SDRs, scholars have relied on the randomized response technique. This method adds noise to the interviewees' responses so that there is no direct link between an answer and the candidate's true status (Moshagen, Musch, Ostapczuk, & Zhao, 2010; p. 379). Second, because the interviewer works with some of the prospect interviewees both directly and indirectly, prejudice and prior judgment are issues (Gillham, 2005; p. 9). The researcher is aware of these external influences, and to compensate for them, the interviewer has reviewed the questions with scholars to determine whether the questions are valid and relevant for this study.

Another potential problem that the researcher is expecting to encounter is also in regard to the interviews. The study expects that the interviewees will not be inclined to participate to this research. The aim of this research is to question the interviewees about the banks' their risk policies which can be considered private material, which makes it potential impossible for risk employers to go public about it. However, due to the necessity of the information that the interviewer needs

for its research and because the interviews are mend as the study's secondary research method, the researcher will not change its data collection method. s

Considering the reliability of this research, which is defined as "the extent to which measurements can be replicated" (Koo & Li, 2016), it is important to note the possible replication errors that might arise from the content analysis and semi-structured interviews. Although validity may be an issue for content analysis, replicability is not. The author provides the reader with his dictionary and coding list in the Appendix, which allows peers to achieve the same results as this study.

However, replication is an issue concerning the semi-structured interviews. Because semi-structured interviews allow interviewees to speak openly and to elaborate or diminish certain aspects of the questions, it is difficult to replicate the results. Nevertheless, the reliability of the research can be enhanced by being transparent about the questions that were asked (see Appendix D) and by providing the interview's transcripts. Finally, the interviewer was unable to conduct the interviews at the same place at the same time, which may affect the results. Unfortunately, due to a lack of resources, the researcher has no means to mitigate these issues. The interviews were conducted at places that are suitable for the interviewees, which can vary from the office to their homes.

4. Results

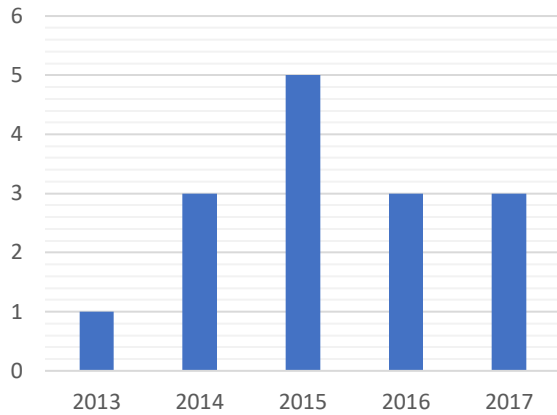**Reputation Risk Management program**

Figure 3: Number of banks that had an RRM program in the period of 2013 to 2017, considering the criteria in Appendix B.
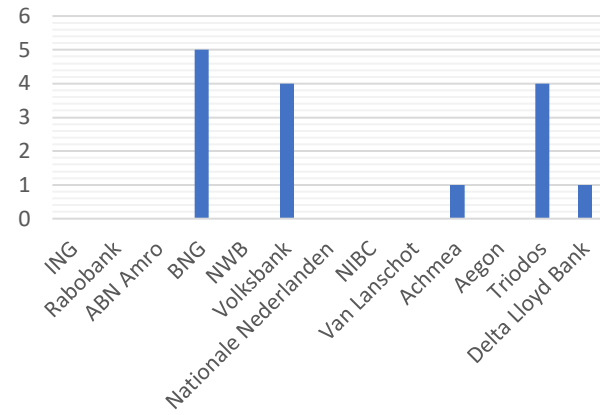

Figure 4: The frequency of times a bank had implemented an RRM program in the period of 2013 to 2017, based on the criteria in Appendix B.

After analyzing the annual reports of 13 public and private banks over a period of five years, the study can show the development of the sample's awareness regarding reputation(al) risk and its management. After manually reviewing the data, the time period provided the study with a total of 64 annual reports, and the results show that, based on the criteria of Appendix B, a total of 15 RRM programs had been implemented. The observations show that, until 2015, there was a steady increase in the number of banks that implemented an RRM program (see figure 3), which is in line with the results of Heidinger and Gatzert's (2018) study. Moreover, the findings in figure 4 visualize that the distribution of RRM program within banks are fairly concentrated. Three of the five banks that implemented an RRM program maintained the program for multiple consecutive years. However, and rather unexpectedly, the number of banks that implemented an RRM program declined after 2015 and remained steady at three banks.

The results show that in the study's time period, five banks had an RRM program at some point in time (see figure 4). The BNG bank was the only bank with an RRM program for all five years. The BNG is a public bank that helps to facilitate the Dutch government with social durable financial solutions. The other banks are private entities. The Volksbank is comprised of former independent banks like the SNS, and ASN, with its vision to be a bank with a human touch. The Triodos Bank displays itself as a durable, transparent, and ethical bank, while finally, both Achmea Bank and Delta Lloyd Bank are part of the larger insurance companies Achmea and Delta Lloyd.

The researcher then examined the influence of the determinants or independent variables on the dependent variable, the implementation of an RRM program.

Size

Size which is in this dissertation defined as the natural logarithm of the total amount of assets banks have, was hypothesized to be a positive determinant whether banks had implemented an RRM program. The argument is that banks with a bigger budget have more stakeholders, all with their own expectations. Hence, bigger banks have more expectations it needs to consider. So, a bank with more resources is better able to establish an RRM that satisfies all expectations than a bank which is smaller in size.

The study started with conducting a F-test. The F-value of 0.717, which is outside the boundary of the critical region (0.446), obliagtes the researcher to conduct a t-test with unequal variances. The size of banks with an RRM (M = 6.850, SD = 2.906, n = 15) was hypothesized to be greater than the size of banks without an RRM (M = 7.217, SD = 3.432, n = 50). This difference is not significant p = .342 (one-tail), and therefore, H_0 is not rejected (see table 2). Hence, the first hypothesis that expected to find that bigger banks are more likely to have implemented an RRM program than banks that are smaller is not confirmed.

Determinants	RRM: 15 observations		No RRM: 50 observations		T-test	F-test	
	Mean	SD	Mean	SD	P-value	Critical region	F-value
Size	6.850	2.906	7.217	3.432	0.342**	0.446	0.717
Table 2: Univariate differences concerning reputation awareness across groups with and without a reputation risk management program. ** Not statistically significant based on α = 5%							

Reputation awareness

The study also examined whether the sum of the frequency of reputation and reputation(al) risk influenced whether it was more likely that a bank installed an RRM program. The study's content analysis shows that banks with an RRM program referred more often to the examined terms than banks without one.

The F-test of the two samples showed that F-value of 1.125 lays within the F-region's critical area (1.899). So, the researcher conducts a t-test with equal variances. The frequency of terms related to "reputation" and "reputation(al) risk(s)" of banks with an RRM (M = 17.6, SD = 9.694, n = 15) was hypothesized to be greater than the frequency of terms related to "reputation" and "reputation(al) risk(s)" of banks without an RRM (M = 11.900, SD = 9.141, n = 50). The t-test shows that this difference is significant $p = 0.018$ (one-tail), and therefore, H_0 is rejected (see table 3). Thus, the second hypothesis which expected that banks that are more reputation(al) risk-aware, are more likely to have implemented an RRM program than banks that are less reputation(al) risk aware is confirmed.

Determinants	RRM: 15 observations		No RRM: 50 observations		T-test	F-test	
	Mean	SD	Mean	SD	P-value	Critical region	F-value
Reputation awareness	17.6	9.694	11.900	9.141	0.018***	1.899	1.125

Table 3: Univariate differences concerning reputation awareness across groups with and without a reputation risk management program.

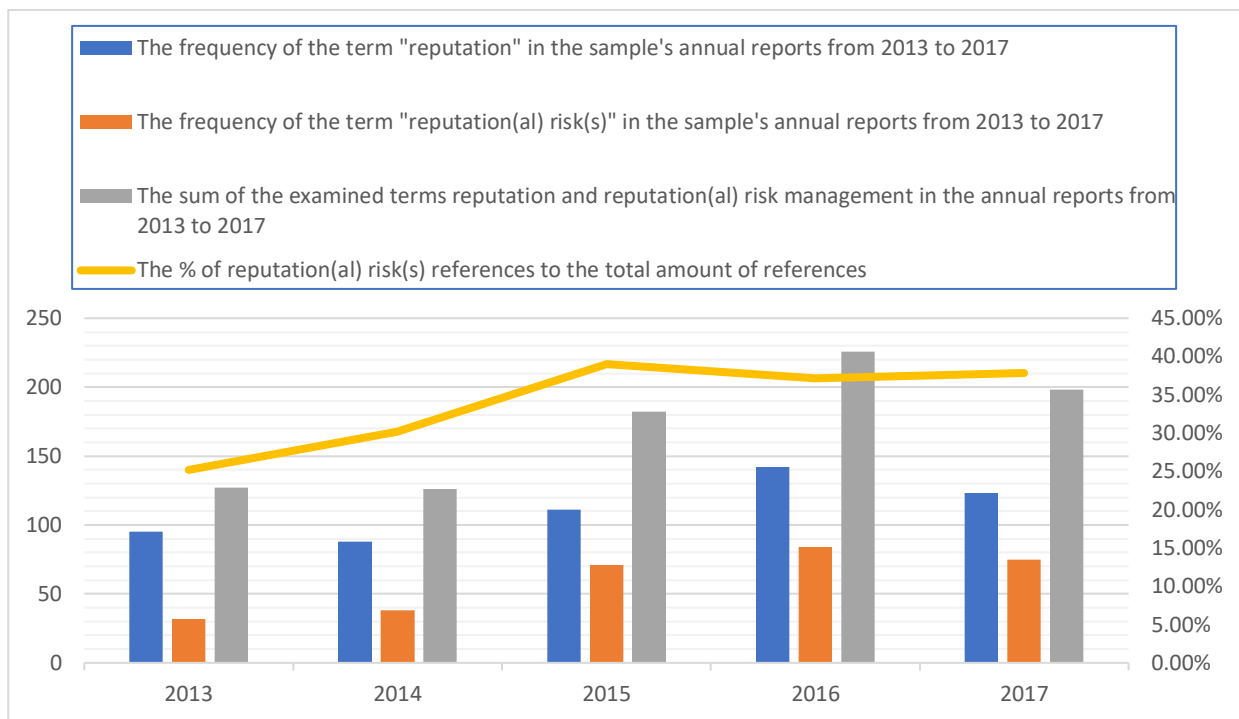*** Statistically significant based on α = 5%

Figure 5: Development of the total number of references divided by "reputation" and "reputation(al) risk(s) for each year between 2013 and 2017.

The study finds that the annual reports of the 13 banks indicate that the sum of the examined terms in 2013 reached 127, with an average of 9.769, while the number of references to the terms in 2017 was 198 with an average of 15.231. In addition, the sum of the frequency of the examined terms grew until 2016, showing a stronger growth of the terms "reputation(al) risk" than the number of occurrences to "reputation" until 2015, which is in line with the findings of Heidinger and Gatzert's study (2018) (see figure 5). However, after 2015, the ratio between the terms "reputation" and "reputation(al) risk(s)" showed a negative change for "reputation(al) risk(s)" in 2016 (-1.84%), after which it remained almost constant in 2017 (37.17% in 2016 and 37.88% in 2017).

Risk awareness

Regarding the level of risk awareness, the study examined whether the sum of the frequency of "risk" could be considered an indication if a bank had installed an RRM program. The study found that banks that did not installed an RRM program, refer more often to the term "risk".

The F-test that was conducted prior to the t-test indicated that the F-value of 0.140 is within the critical region (0.446). So, a t-test with equal variances is executed. The frequency of terms related to "risk" of banks with an RRM (M = 881.133, SD = 271.372, n = 15) was hypothesized to be greater than the frequency of terms related to "risk" of banks without an RRM program (M = 1009.580, SD = 724.788, n = 50). This difference was not found to be significant p = 0.253 (one-tail), and therefore H_0 is not rejected (see table 4). Thus, the third hypotheses that expected to find that banks that are more risk-aware, are less likely to have implemented an RRM program than banks that are more risk-aware is not confirmed.

Determinants	RRM: 15 observations		No RRM: 50 observations		T-test		F-test
	Mean	SD	Mean	SD	P-value	Critical region	F-value
Risk awareness	881.133	271.372	1009.580	724.788	0.253**	0.446	0.140

Table 4: Univariate differences concerning reputation awareness across groups with and without a reputation risk management program.

** Not statistically significant based on α = 5%

However, the sum of occurrences of the term "risk" grew until 2015, after which the sum of the term's frequency declined (see figure 6), indicating that the sample became less concerned with risk. So, the study finds that the third hypothesis, which expected that banks who are more risk-aware are less likely to have an RRM program than banks that are less risk-aware is rejected.
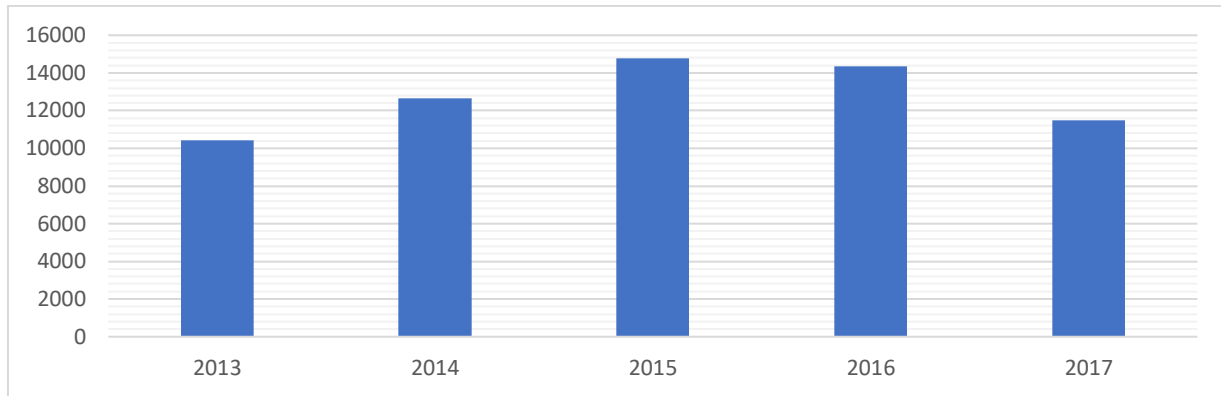
Figure 6: The sum of references to the term "risk" in the sample's annual reports of 2013 to 2017.

Compliance, integrity and fraud

Finally, the number of times reputation was linked to a concern about compliance, integrity, and fraud increased each consecutive year starting in 2013, and the number more than tripled compared to 2017 (from 14 to 45) (see figure 6).

Prior to the t-test, the researcher conducted a F-test to determine whether the variances in both populations were equal. The study found that the F-value (0.712) laid outside of the critical region (0.527). The result of the F-test is that the researcher needs to conduct a t-test with unequal variances.

The frequency where reputation was linked to a concern about compliance, integrity, and fraud was hypothesized to be greater at banks that implemented an RRM program (M = 2.533, SD = 2.356, n = 15) than banks that did not implemented an RRM (M = 2.260, SD = 1.988, n = 50). This difference was not found to be significant, $p = 0.344$ (one-tail), and therefore, H_0 is not rejected (see table 5). Thus, the final hypothesis which expected that those banks that referred more frequently to reputation in consultation with compliance, integrity and fraud were more likely to have implemented an RRM than banks that referred less frequent towards reputation together with compliance, integrity and fraud was not confirmed.
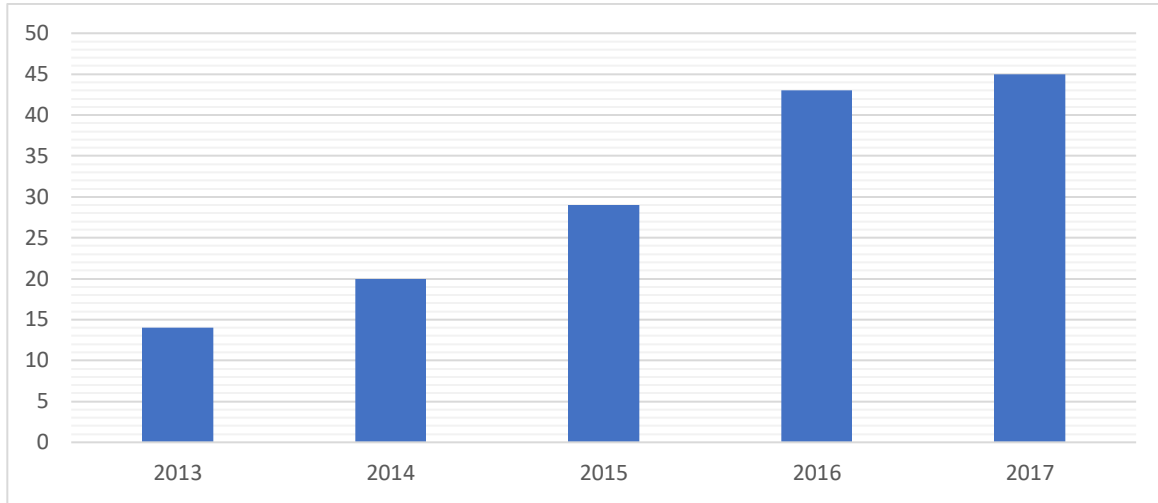
Figure 7: The total amount of references where reputation is related to compliance, integrity, and fraud concerns divided by year.

Determinants	RRM: 15 observations		No RRM: 50 observations		T-test	F-test	
	Mean	SD	Mean	SD	P-value	Critical region	F-value
CIF	2.533	2.356	2.260	1.988	0.344**	0.527	0.712

Table 5: Univariate differences concerning reputation awareness across groups with and without a reputation risk management program.

** Not statistically significant based on α = 5%

5. Analysis

The number of STRs banks are obligated to report under the AMLD saw a heavy increase in 2017 compared to the four years prior. This study aimed to determine to what degree the RRM of the banking industry has been a factor in the increase of STRs. The study's content analysis, which was performed on the annual reports of the top 13 banks between the years 2013 and 2017, has shown that these banks have become more aware of their reputation and the risks associated with it. The results of the content analysis have been verified by two interviews with risk employees who were part of banks' ERM. The final analysis uses Lessig's conceptual model to show how the four modalities have impacted the banks' awareness surrounding its reputation, and how this increasing awareness has changed the industry's behavior.

The reputational damage of the financial crisis

After the financial crisis of 2008, according to both experts, the banking industry was no longer considered a profession of decency that facilitated financial services for working people. Bankers were suddenly seen as "people greedy for money and status", according to the second expert. Both experts note that the experience and knowledge consumers had after the financial crisis, led to an alteration of consumers' perceptions (Honey, 2013; p. 11). As a consequence, the business's reputational value diminished, reducing banks' ability to enjoy other benefits, as well, such as attracting new employees (Honey, 2013; p. 10), which the second expert underscored. The second expert imagined that new, fresh talent would favor more to work for a new FINTECH company that has fewer policies in place and a better reputation than the "old established" banking industry. So, the second expert, is aware that prospective employees may use the "exception attribute" of reputation to differentiate between FINTECH companies and the banking industry (Honey, 2013; p. 11). As Honey (2009; p. 9) has argued, corporations can do little to change stakeholders' beliefs, but they can influence the knowledge and experience people associate them with. Therefore, both experts argued that, after the financial crisis, banks have started to invest in the relational construct (Honey, 2009; p. 8) with stakeholders to regain their reputation. This long-term process is based on what a company does rather than what it says (Honey, 2013; p. 10).

The content analysis has shown that the banking industry became more aware of its reputation between 2013 and 2017. These results align with the trend laid out by Heidinger and Gatzert (2018) and Aula and Heinonen (2016), who found that firms have become increasingly

more aware of their reputation since 2009. The frequency of terms related to reputation and reputational risks in the banks' annual reports rose from 2013 to 2017. Given that the number of references to reputation and other related terms is considered a proxy for the level of banks' awareness, the study shows that the banking industry has become more conscious of possible events that may hurt the business's reputation.

It is not surprising that firms have started to become more aware of their reputation, especially in the financial sector, where reputation and trust are sometimes used interchangeably, as was the case in the first interview. Moreover, both scholars and risk practitioners have stressed the importance of trust, noting that stakeholders' level of trust in a bank or industry generally has a strong effect on its value (Gaines-Ross, 2008; Economist Intelligence Unit, 2005). Finally, both experts considered reputation as a potential source of competitive advantage. At the same time, a good reputation can help the banking industry convince the public that it behaves ethically (Gaines-Ross, 2008; pp. 6 – 7), which, in the case of the AMLD, is highly useful because the AMLD is also concerned with bankers' conduct and integrity.

An increasing amount of compliance risk

In the aftermath of the financial crisis, regulators increased the legal obligations under which the banking industry needed to operate, not only with the aim of preventing another crisis from occurring, but also from a security perspective. As a consequence, the probability that an adverse effect materializes from failing to comply with existing regulations has increased. According to an industry survey and this study's experts, compliance risk is considered a major risk for a company's reputation (Economist Intelligence Unit, 2005).

The AMLD of 2017 is not only a regulatory obligation but also a tool for government and law enforcement agencies to combat crime. With the help of STRs, the AMLD aims not only at protecting the integrity of the financial system but also at combating crime and sanctioning those whose conduct is inappropriate. The results of the content analysis show that, from 2013 to 2017, the sum of total references to compliance-, integrity-, or fraud-related concerns more than tripled, indicating that the industry has become more aware of risks that could be classified under the AMLD. For example, Volksbank noted in 2017:

"Compliance risk: is the risk that the Company and/or its employees do not completely or accurately comply with the (ratio) of written and unwritten rules of corporate integrity and conduct and may be held responsible for such conduct, which may lead to loss of reputation and/or financial loss" (2017; p. 247)

Volksbank is one of the banks that had an RRM program installed during this study's analyzed time period, which was found to be a significant influence on the bank's reputation awareness. However, Nationale Nederlanden, a bank without an RRM, stated the following in its annual report:

"NN Leven is committed to the preservation of its reputation and integrity through compliance with applicable laws, regulations, and ethical standards in each of the markets in which it operates (business conduct risk). All employees are expected to adhere to these laws, regulations, and ethical standards, and management is responsible for embedding the compliance-related rules" (2017; p. 89).

Thus, both banks, which differ significantly from the perspective of their reputation awareness, are at least concerned with legislation that can be classified under the AMLD.

According to both experts, banks are not only aware of these compliance risks but also committed to handle these risks, which is shown by the investments the banking industry has made. The experts argued that, after the financial crisis, the industry has made the necessary investments to regain its reputation. However, as becomes clear from the literature, the industry's surveys and the two experts, measuring reputational risk is difficult and is always an estimation (Economist Intelligence Unit, 2005; Honey, 2013). Thus, although banks try to quantify the amount of risk they are exposed to, and, therefore, attempt to determine what their risk attitude should be, it remains uncertain how much risk banks run and how much of a buffer the industry should incorporate to align the amount of risk with its risk appetite.

Banks' inability to measure exactly how much risk they run through their business operations is due to the conscious, unconscious, and affective factors that influence reputational risk. However, according to the second expert, while the banking industry has tried to measure the conscious factors with the net promoter score and the employee engagement score, it remains an issue how much unconscious and affective factors influence the banks' risk exposure. The

increasing amount of awareness that compliance risk could reduce banks' value, which also concerns banks' reputation has led the industry to change their behavior and mitigate this risk.

Banks' mitigation process of compliance risk

According to Honey (2013), banks have three forms of risk-handling techniques in the case of reputational risk: avoid, manage, or mitigate. The AMLD and the specific compliance risks are part of the banks' business activities, risk managers are therefore only in the position to manage and mitigate the negative consequences that banks may suffer. The content analysis shows that banks are not only aware of these issues but both experts acknowledge that banks are also investing to handle these risks. Banks mitigate the compliance risks stemming from the AMLD by investing in the number of personnel responsible for the first and second lines of defense, their IT-systems, and, therefore, the budget that is reserved for these measures. With these techniques, banks hope to keep the amount of reputational risk at an acceptable level that remains within their risk appetite.

The second expert noted that the number of personnel responsible for executing the five-step requirement has expanded. Now, banks have more executive personnel who are responsible for identifying clients that that pose a risk for the business. By reporting more STRs about potential criminals to the national FIU, banks mitigate the risk stemming from failing to comply the obligations under the AMLD. As more STRs are submitted, banks show according to the head of the FIOD that they act more in compliance with the AMLD.

Furthermore, the compliance department has also seen an increase in the number of personnel. According to both interviewees, the mandate of this department has gradually increased to manage the various risks, such as reputational risk. Moreover, because there are more personnel responsible for banks' second line of defense, banks should become less ignorant of the law, possibly better enabling them to act in accordance with current legislation. So, with a bigger compliance department, the department is better able to make its voice heard by upper management, and possibly better steer the course of the bank's operations. The compliance officers also have a vote in the decision-making's process regarding a new project, which enables the second line to better manage and mitigate the possible risks from the endeavor.

Finally, the second expert noted that banks have invested in their IT-systems to be better able to locate suspicious transactions that are of interest for the first line of defense. However, the order in which the investments were made remains a chicken and egg conundrum. The study could

not determine whether banks started to increase the amount of personnel responsible for the execution of the five-step requirement or started to improve their systems. Moreover, although the content analysis found that some banks had implemented an RRM program and some did not, the study could not verify whether this had an effect on how much banks invested in their RRM program.

Based on the modalities described by Lessig, the content analysis finds that banks feel subjected to the expectations and compliance risks stemming from the AMLD, which are according to the experts incentivizing them to invest in their first-, second line of defense and their IT-networks. The content analysis found that, from 2013 to 2017, the degree to which the banking industry became aware of its reputation and especially reputational risk increased, suggesting that banks continue to have a more proactive stance concerning reputation risk. This stance and the growing expectations from stakeholders have made the banking industry more active in managing the largest risk to its reputation, namely compliance risk. Now, banks have become more knowledgeable of the law, and the industry is better able to identify, manage and mitigate the reputation risk from failing to comply with the AMLD. Therefore, banks are more aware of their reputation and the risks that could damage it, which leads to more resources being spent on "living up to the expectations issued by the community," being "less ignorant of the law," and "modernizing their IT-systems." The alteration of banks' behavior to protect their reputation and regain what they lost started after the financial crisis has arguably led to more STRs being reported to the FIU, which as a consequence not only helps to show that the industry behaves ethically but also in combating ML/TF.

6. Conclusion

Banks' behavioral change

The first significant conversation about money laundering was held during the 1988 Vienna Convention. A year later, the G7 summit founded the FATF, which has the mandate of preventing financial institutions from being used for ML and, after 9/11, to combat TF. The FATF has issued a total of 49 recommendations that explain how both the financial industry and national governments should work together to protect the integrity of the financial system. Today, in 2019, the EU has adopted the most severe AML legislation in the region, and it addresses how the financial industry should implement an RBA to monitor for suspicious behavior. Based on the RBA, it is recommended that the banking industry screen new clients and establish whether the source and their expenses seem plausible. When specialized analysts find a financial service that seems out of the ordinary, the financial institution is obligated to make an STR and issue it to the national FIU. The FIU uses these reports to find new trends in financial crimes and to start new investigations.

By 2017, the number of STRs saw a heavy increase compared to previous years. This study found it of interest to determine what this growth could explain. In the years before and after 2017, many different banks were found guilty of failing in accordance with the AMLD, which has resulted in many losses, such as the bank's reputation. This study then argued that banks have greatly invested in their effort to control the compliance risk that could harm their reputation, which led the banking industry to issue more STRs. Therefore, the central question this dissertation addresses is the following: *To what extent can Dutch banks' reputational risk management explain their increase in reporting suspicious transactions from 2013 to 2017?*

The study's content analysis and interviews found that banks did not only become more aware of their reputation in general but also the threats that could harm this intangible asset after the financial crisis. By using Lessig's conceptual model to analyze the findings, the research showed that because banks became more aware of their reputation, due to increasing expectations and regulations, banks feel more subjected and incentivized to make the necessary investments to manage and mitigate these risks. Thus, the AMLD is a risk for banks' reputation, which is why they made the resources available to hire more personnel that performs AML activities, while at the same time modify their IT-systems. These investments enhance the capacity of the banking

industry to perform the five-step requirement which arguably had led to an increase of STRs. So, to answer the dissertation's central questions, banks invested in their capability to perform the obligations under the AMLD to protect their reputation from compliance risk, which in effect has arguably led to an increase of STRs. However, the study lacks some power, making the research less able to find a real causal relationship between a behavioral change and the increase of STRs.

Limitations

This study's main method of analysis was a content analysis, which is a highly reliable research method but lacks some strength from the perspective of validity. To enhance the validity of the content analysis, the researcher chose to conduct several interviews with former risk employees at the banks this research examined. Although the researcher used three kinds of methods to approach relevant employees, such as LinkedIn, e-mailing, and a targeted convenience sampling, only the latter led to two interviews. The reasons why those that were approached did not want to participate, was because they had no interest, had no time or were not able to share any information about internal risk policies. The latter was already of a concern, highlighted at the beginning of the research by Gordon (2011).

The two interviews were held with one former risk consultant and a former credit risk employee. The employees were working for two separate banks, one with an implemented RRM program and one without in the period of 2013 to 2017. When the first interview started, the researcher was made aware that the results of the interview could be destroyed if it was found that the results were not in accordance with the interviewee's non-disclosure agreement.

The researcher found it imperative that the results could be used in the study, and because at that point in time, there were no further interviews planned, the researcher made the ad-hoc decision to make the interview's questions more general. Thus, instead of focusing on the banks' policies, the researcher asked the employee about his/her view and experience. The researcher found this form of questioning legitimate because he believed that the interviewee's view on RRM was based on experience. Thus, by questioning the interviewee about his/her view, the questions were indirectly aimed at the experience they gathered from their former employer, which was relevant for this study. However, because the researcher hoped to get more information about banks' internal risk policies but was only able to retrieve information based upon experience, the study validity was not as much strengthened as was intended. Moreover, the decision also steered

the researcher not to question the interviewees about the order in which the investments were made. The consequence is that the study encountered some difficulties in explaining exactly which incentive was of most concern to the banks and drove the discussed investments.

Moreover, the study's method of analysis is based on the assumption that the frequency of the terms that are recorded in Appendix C reflects banks' level of awareness in regard to that category. Although other scholars have also used this method of analysis, it is questionable because, as the Scientific Council for Government policy explained in their 2017 rapport, awareness does not automatically lead to behavioral change (WRR, 2017). Furthermore, Lessig's conceptual model does not specify how much awareness of social norms and law is required to eventually alter an actor's behavior. Thus, the research's methodology leaves room for discussion and criticism.

Although the decision seemed justified at the time, the study now lacks some explaining power, making this research unable to show a causal relationship between the behavioral change and the increase of STRs. With the benefit of hindsight, the researcher could have decided to divide his questions into two separate sections. The first part could have been based on the expert's experience, and the second part could have addressed internal policies. The question that the interviewer had missed to ask due to his ad-hoc decision is whether the investments had led to an increasing amount of STRs being issued. If the interviewee than later declared that the second portion of the interview had to be destroyed, the researcher would at least have tried to strengthen its validity and find that important causal mechanism. Despite these limitations, the study is still relevant from both a practical and scientific standpoint.

The study's practical and scientific relevance

In practical terms, the study shows that the Dutch banking industry has made the necessary investments to better monitor for suspicious activity, increasing the chance that criminals are caught, and therefore causing the level of crime to decrease. Banks are now issuing more STRs to the FIU, and the expectation is that this number will only further increase for the coming years. As a consequence, banks are providing law enforcement agencies with more valuable information about suspicious behavior, which the FIU uses to open new investigations and for new leads in an ongoing inquiry. Sharing this kind of information raises the chance that criminals are found and

prosecuted, which leads to less crime (Ferwerda, 2008). So, the conclusion of this study is from a practical point of view positive.

Furthermore, the research is the first who examined how reputational damage is influencing business' behavior in the context of the AMLD. The study finds that banks have become more aware of compliance risks in general but also with the AMLD in specific, leading to an alteration of banks' behavior. However, the study could not quantify the amount of investments banks made to change their behavior because the industry did not consider that it was in their interest to share the changes, they made about their risk policies. Still, the research has delivered some interesting findings.

The implications of the findings

The first study into how reputational risk management influences the behavior of banks with regard to AML legislation has thus found some interesting results. It suggests that reputational risk management is a great incentive for banks to change their conduct because banks are aware that a negative perception can reduce their value and their competitive stance in the market. It is not surprising that according to the experts and the content analysis, banks are aware that when they fail to comply with existing regulations, the company suffers from the negative media coverage and the negative perceptions of shareholders. More specifically, one result that the researcher found of great interest, is the amount of times the annual reports refer to reputation in relation to the risk stemming from compliance-, integrity-, or fraud-related issues. From 2013 to 2017, the number of references more than tripled. The author argues that this finding is especially of interest because it shows that the Dutch banking industry has become more aware of the reputational risk that the AMLD may pose. Given its nature, the AMLD is a compliance risk that aims to protect the integrity of the financial system and to prevent financial fraud. So, because banks are aware that their reputation is subjective to the AMLD, they make the necessary investments to manage and mitigate the risks, with the expectation to protect their valuable assets.

However, the study was unable to find some significant relations between the various determinants the study found from interest. The results showed no significant relation between banks that have implemented an RRM and banks that are bigger, more risk aware, and refer more often to compliance, integrity and fraud related concerns. Suggesting that these three determinants do not significant influence the likeliness that a bank has implemented an RRM program. The study

did find that the determinant of "reputational awareness" has a significant influence on whether a bank has implemented an RRM program, even though the sum of occurrences to RRM declined after 2016.

Despite the finding that the sum of references to RRM declined in 2017, suggesting that banks have become less aware of their reputation by 2017, the researcher still expects that the number of STRs will continue to increase in the next few years, only to eventually decrease. The number of STRs will continue to increase in the coming years because banks have not yet had the time to fully show the results from their investments. In a few years' time, it is expected that both the IT-systems and the experts concerned with AML activities are better capable to monitor for suspicious transactions, likely to result in more STRs. However, over time the researcher predicts that the experience of personnel and the cooperation between the FIU and banks will increase, making banks better able to determine what is and what is not a suspicious transaction, resulting in a decrease of false-positives and less STRs being put out. What the actual outcome will be of this expected growing cooperation between banks and the FIU, is a possible field of interest for other scholars.

Unexplored avenues

Future research into the conduct of banks with regard to AMLD policies may be more fruitful, than this study has been. What sparked interest in this study was the scandal at ING bank, which led to a record fine issued by the Dutch Department of Justice. When the study began laying its groundwork, more and more banks were becoming transparent about the investments they made to comply with the AMLD. For example, all banks have announced that they have invested heavily to live up to the requirements in the AMLD (Volkskrant, 2019). If a future researcher questions the reasoning behind these investments not from the perspective of risk management but from a transparency point of view, scholars might be able to retrieve the necessary validity this research lacks.

Another avenue that might be of interest for future scholars is to determine whether the quality of STRs, meaning less false-positives increases. From the same report published by Volkskrant (2019), banks still find it difficult to track suspicious transactions despite the investments they have made. This is partly due to the fact that there is no clear line as to what is considered "suspicious" and what is viewed as "legitimate." Therefore, an STR is highly

subjective, making it real possible that a big portion of the total STRs are false-positives. A future scholar is possibly able to determine whether the number of STRs being used for further (criminal) investigation also increases by looking at the FIU annual report. If the number of STRs that are used for investigations also increases, it may be a sign to assume that the quality of STRs becomes better, meaning that the number of false-positives the FIU receives declines.

Another aspect that is relevant here, is the cooperation between the FIU and banks. The FIU provides banks with information about new ML/TF trends, enabling them to better monitor for such behavior. More cooperation in this regard can also lead to a more effective way of banks screening their clients, allocating the funds where they are needed. As the second expert noted at the end of the interview, "regulators are incentivizing banks to work more closely together on the issue of screening." However, as the expert also noted, due to clients' privacy and issues surrounding competition, executing such a plan may be difficult.

Despite all of the shortcomings of banks, regulators, and law enforcement agencies to track ML/TF, it remains crucial that the fight continues. ML/TF drives both criminal and terrorist activity, so from a security perspective, it is imperative that these actors work together in the search for new means to find such funds. Cooperation is in this case key, it is like Helen Keller said, "Alone, we can do so little; together, we can do so much."

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Appendices

Appendix A

Beste heer, mevrouw,

Onderzoeksonderwerp
Mijn naam is Robert Meulenhoff en ik doe onderzoek naar tot in hoeverre banken hun werkwijze aanpassen om reputatie risico's met betrekking tot witwasschandalen en terrorisme financiering te minimaliseren.

Verantwoordelijke
Ik ben de enige verantwoordelijke voor het afnemen en de uitkomsten van het interview.

Waarom uw bijdrage van belang is
U bent door de auteur benaderd omdat uw werkzaamheden bij International Card Services betrekking hebben tot de verplichtingen die voortvloeien uit Wet ter voorkoming van witwassen en het financieren van terrorisme. U bent daarom in de professionele positie om de vragen (hieronder) te kunnen beantwoorden.

Verwachte uitkomsten
De onderzoeker verwacht dat de respondent inzicht kan verschaffen hoe International Card Services omgaat met de risico's van reputatie schade van eventuele schandalen die betrekking hebben tot witwassen en het financieren van terrorisme.

Duur
De verwachting is dat het interview een halfuur zal duren.

Plaats
De onderzoeker zal de respondent binnen een week (na verleende toestemming) ter kennis stellen waar het interview zal plaatsvinden.

Vragen
De vragen die tijdens het interview aan bod komen worden 24 uur voorafgaand van de opname naar de respondent verstuurd (bij voorkeur e-mail). De interviewer houdt wel het recht om door te mogen vragen indien de respondent een antwoord verschaft die voor de auteur verder van interesse is.

Anonimiteit
De interviewer zal in zijn onderzoek noch de naam noch de toenaam van de respondent gebruiken. In plaats daarvan zal de onderzoeker de functieomschrijving van de persoon beschrijven om aan te geven wat zijn of haar inbreng is.

Opname
Voor het onderzoek is het van belang dat er een transcript volgt van het interview. Daarom is het van belang dat het gesprek wordt opgenomen.

Herzien

Indien de respondent op enig moment tot het besluit komt om zich terug te willen trekken, dan is dat mogelijk. Er wordt dan van de respondent gevraagd om de interviewer een e-mail toe te sturen waarin wordt aangeven dat deze niet langer wilt participeren aan het onderzoek. De antwoorden die tijdens het gesprek zijn gegeven, zullen niet in het onderzoek worden gebruikt. Ten slotte zal de opname verwijderd van elk medium.

Contactgegevens onderzoeker

Schroom in geen enkel geval om contact te leggen met de onderzoeker. Contact is mogelijk via de volgende kanalen:
E-mail: robertmeulenhoff@gmail.com
Telefoonnummer: 06-53617341

Appendix B

Qualitative reputation risk management identification criteria and keywords

Set RRM = 1 (reputation risk management implemented) if at least one of the following criteria is satisfied:

1. *Own risk category* in risk management section or subsumed with other risk types under one heading but with separate definition (reputation risk subsumed, e.g., in section on: brand and reputation(al) risk, strategic, reputation(al), contagion and emerging risk, (non-)compliance and reputation(al) risk, compliance, conduct and reputation(al) risk)

2. Framework:

Reputation(al) risk framework
Reputation(al) risk management framework
Reputation(al) risk control framework
Reputation key risk framework
Reputation(al) risk principal and key risk framework
Framework to protect its reputation
Reputation(al) risk policy
Reputation(al) risk governance policy
Policy for reputation(al) risk control
Reputation(al) risk governance guidelines
Guideline on the management of reputation(al) risk
Reputation(al) risk management program
Directive on controlling reputation(al) risk

3. Committee/function

Reputation(al) risk committee
Reputation(al) risk management committee
Reputation(al) risk review committee
Reputation(al) risk policy committee
Reputation committee
Reputation(al) risk governance function
Reputation(al) risk council
Reputation council
Reputation(al) risk forum
Reputation(al) risk department
Reputation(al) risk management department
Reputation(al) risk management office
Reputation(al) risk management team
Reputation(al) risk measurement and control unit
Reputation(al) risk (sub-)function
Corporate office of reputation(al) risk
Corporate office of reputation(al) risk management
Reputation(al) risk steward
Head of reputation(al) risk

Appendix C

Indicators	Code
Category: Reputation awareness	
Reputation	Green
Reputation(al) risk	Purple

Category: Compliance Integrity and Fraud (CIF)

Compliance	Pink
Integrity	Pink
Fraud	Pink

Appendix D

Onderwerp	Vraag	Prompt
Introductie	Ik zal graag willen beginnen met u te vragen naar uw functie?	Taakomschrijvingen, verantwoordelijkheden
	U bent dus ook verantwoordelijk voor reputatiemanagement	Ja / Nee
Ervaring	Hoelang bent u werkzaam bij (de) [banknaam]	
Doel	Kunt u mij vertellen waar de bank naar streeft?	Doel, missie, visie
Risicomanagement	Om dit doel te bereiken, in hoeverre speelt risicomanagement daarbij een rol?	Niet matig behoorlijk
1. Reputatiemanagement	Is reputatiemanagement een onderdeel van risicomanagement?	Ja, nee
Negatief	Nee, Wat maakt dat reputatiemanagement geen onderdeel vormt van risicomanagement binnen (de) [banknaam] Vormt het wel een onderdeel van (de) [banknaam] zijn bedrijfsvoering? 2) Nee,	

	Bent u wel van mening dat reputatiemanagement wel een positieve uitwerking kan hebben op (de) [bank]? 2) Ja, Op welke wijze wordt er binnen [banknaam] invulling gegeven aan reputatiemanagement?	
Positief op 1.	In hoeverre is het bewustzijn van reputatiemanagement binnen (de) [banknaam] over de afgelopen 5 jaar veranderd? 2) Ja, Op welke wijze wordt er binnen [banknaam] invulling gegeven aan reputatiemanagement? 3) Ja, Wat zijn volgens u deze positieve uitwerkingen? [Schakel door naar vraag 4) 3) Ja,	
Perceptie van reputatiemanagment	(De) [banknaam] reputatiemanagement als een (op zich zelf staand) onderdeel van risicomanagement/ compliance / strategic / non-financial / operational risk. Zou er naar uw idee een verschil zijn als reputatie management beschouwd zou	Nee, ja

	worden als een eigen categorie van risico of zou vallen onder compliance/ strategic / non-financial / operational? Waar is uw ervaring op gebaseerd en kunt u dat toelichten?	
Reputatieschade als gevolg van niet in compliance zijn	Ja, Bent u van mening dat het niet voldoen aan wetgeving zou kunnen leiden tot reputatie schade Neutraal Wat maakt dat u denkt dat wetgeving wel/niet zal leiden tot een reputatieschade? 4.1) Ja, Wat zijn de mogelijke gevolgen van reputatieschade wanneer (de) [banknaam] niet voldoet aan wetgeving?	Ja, nee Verlies van vertrouwen vanuit publieke instanties, particulieren, bedrijven die geen zaken meer willen doen, investeerders die zich terugtrekken
Reputatiemanagement investeringen	5) Ja, Heeft u het idee dat (de) [banknaam] investeert vanuit het belang van reputatiemanagement om ervoor te zorgen dat (de) [banknaam] voldoet aan wetgeving 6) Nee, Zou de bank naar uw mening moeten stoppen/blijven investeren?	Ja, nee Wat is de waarde van deze investering?

	Wat maakt dat u van mening bent om dit wel wel/niet te doen?	
	Ja, Op welke wijze worden die investeringen zichtbaar gemaakt?	**Geld (FTE), systemen, het betrekken van juristen,** cultuur (aan de top), publieke statements.