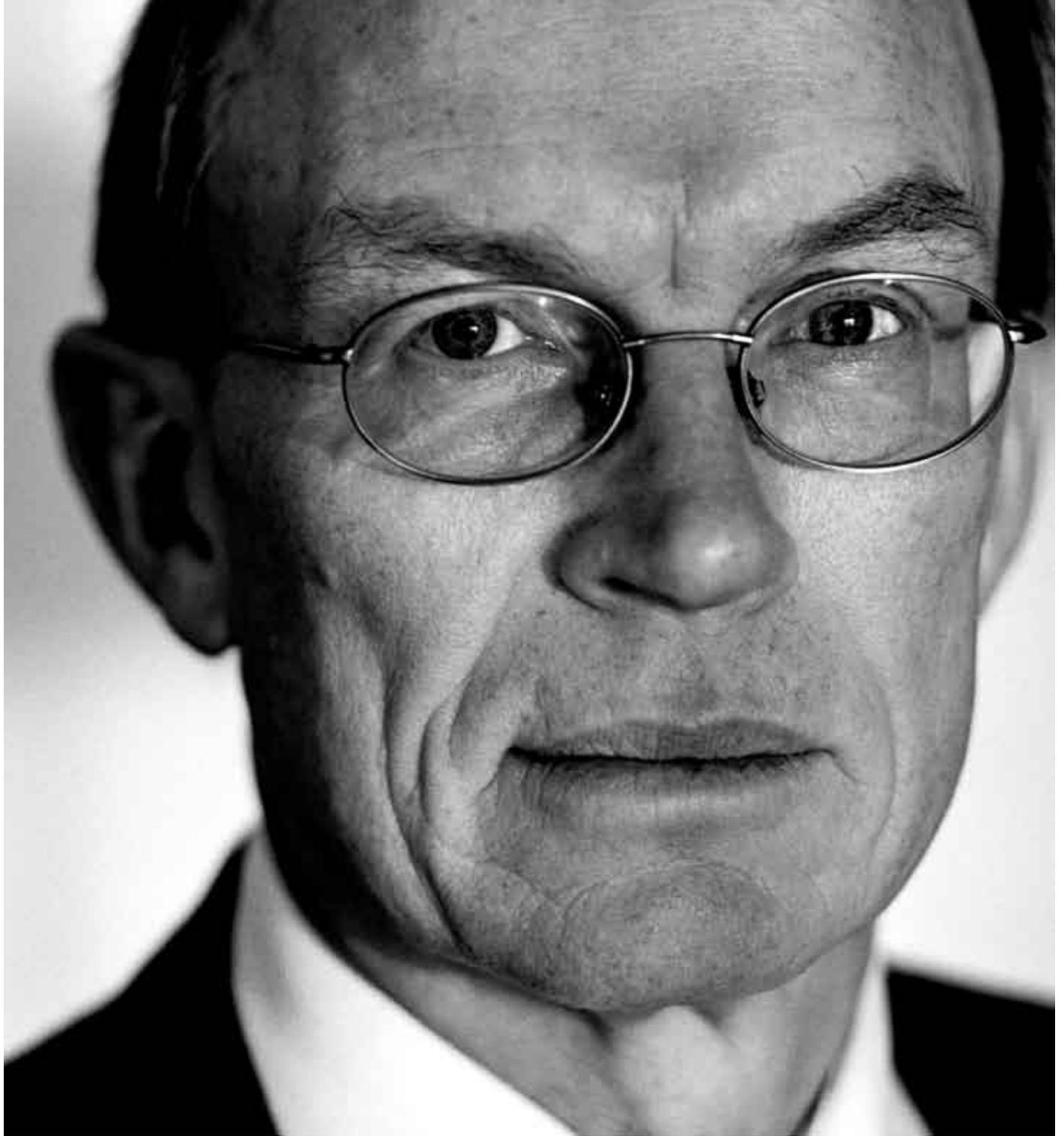


‘You want to be held
accountable for behaving in
line with reasonable social
standards’

Arnold Schilder



Making sure that your integrity remains intact – that is what really matters, according to Arnold Schilder, Chair of the International Auditing and Assurance Standards Board (IAASB). He points out that integrity seems to have a strange, dual nature. It's there; and it's not there. As (until recently) a member of the governing board of the Dutch central bank (DNB) with special responsibility for banking supervision, but also as an ordinary citizen, he has lived constantly in that field of tension. Resolving the tension by pinning everything down in rules is not an option, as far as he is concerned. Schilder is the type of person who prefers to reach agreement with others on sensible 'rules of the game'. 'There are always things you don't agree on, but through mutual respect and trust, you can still get closer to each other.'

‘People are under more and more pressure: if they’re not to succumb to it, they need to keep a straight back’

He studied Theology, and chose Ethics as his main subject. It is perhaps not surprising, therefore, that Arnold Schilder takes a subtle approach to integrity. Integrity, he believes, is not something you can take for granted. ‘It’s strange. It’s not for nothing that we get worked up about it: we want to be able to rely on it, after all. We want to be able to hope for it, too – even though experience repeatedly teaches us that we’re likely to be disappointed. So integrity is not an experiential fact; it’s more a sort of working hypothesis that, by mutual, tacit agreement, we’ll treat each other with integrity. This applies both at home and at work. At work, the tacit agreement is that directors will act with integrity. But that’s where the trouble starts: how can you be sure they’ll actually act like that? So you need to scrutinise them before appointing them. And to make sure that scrutiny takes place, you need rules and regulations. That’s why directors of financial institutions, for instance, have to be carefully screened by the supervisors before they’re appointed. But we shouldn’t kid ourselves that that really solves the problem. All we can say is that we’ve done our best. The willingness to assume that people will behave with integrity is a mechanism for ordering human interaction that we’ve only managed to incorporate into civilised society with a fair amount of effort.’

Keeping a straight back

In his work as a managing board member, Schilder has noticed that integrity is indeed sometimes a hard-won quality. ‘We’ve also had big disappointments. You assume that people will tell you things you should know, but that’s not always the case, unfortunately. Sometimes you realise (after the event) that people have told you something that’s untrue – or only half-true. I’m not sure whether that’s because I’ve had now had some ten years’ experience of this work, or whether times have changed. I think it’s the latter.’ These changed times, he says, are above all hectic, and that in turn has an effect on integrity. ‘People are under more and more pressure. If they’re not to succumb to it, they need to keep a straight back: to tell the truth and say what they think. That’s not always easy: after all, they have to repeatedly cope with setbacks and report them to others – that’s not what they’d expected their job to be like. People have to take decisions in tense circumstances. Not everyone is able to maintain their integrity under those conditions.’

This is how we do things

Not only people, but organisations, too, are expected to act with integrity. That means that integrity is expressed in the way people in the organisation consciously interact with each other and with their organisation itself. How do you embed that deliberate behaviour in an organisation? ‘One thing you must not do is go around commandeering everyone. At DNB, we decided in 2005 to do more in our supervisory approach to encourage integrity. Until then, integrity had been more or less the exclusive territory of internal audit. As part of our effort to strengthen the focus on risk in supervision both within and between institutions, we made integrity a key element in our DNB

Vision on Prudential Supervision 2006-2010. Integrity in this context is all about preventing violations of integrity, taking measures to combat the laundering of money obtained through crime, for instance, or through fraud or for financing terrorism. I think this has been an important step forward, and a clear break with the past.' Was this influenced at all by the events of 9/11? 'Well, certainly more value is now being placed on people behaving as good citizens, people society can rely on,' says Schilder. 'This is quite a striking change and, to my mind, had a lot to do with 9/11. It was an enormous shock in 2001 that something like that could be prepared and carried out within one's own society. The reaction was that this is something we must protect ourselves against by introducing strict rules and legal penalties.'

Creating support

Over the past few years, Schilder has put a lot of time and energy into encouraging people to hold each other accountable for their integrity. How does that work in practice? 'It's vitally important in these sorts of processes

that you create broad support for integrating something in the core values and basic principles. To start with, you have to explain how you propose to do it, but at a certain point it becomes a standard that people are willing to be held to.' The same applies, more or less, to transparency – something else that cannot be taken for granted but which can be learned. 'When I was an auditor of large corporates in the nineties, it was considered a good thing if the company could smooth out the results, and eliminate any unexpected fluctuations. That way, investors would not be confronted with any nasty surprises. Everyone thought this was great. I also thought it was good to take a prudent approach: after all, you never knew when you might meet some setbacks. In the end, that approach didn't prevail. People said, "It's not your job, as managers, members of supervisory boards, regulators or auditors, to take decisions on behalf of us, shareholders and investors. If there's a problem, just explain it to us, and we'll give you our response." Society has taken over much more responsibility for transparency itself. People are fed up with things being decided secretly in "smoke-filled back rooms".'

Dilemma

Reminiscing about the past in this way, Schilder seems to view those times with a certain nostalgia. 'That is perhaps so,' he says. 'So much attention is being paid these days to transparency and what we're pleased to call market value. But maybe it's just making matters worse. I fear that the idea that the market will correct everything is based on a misunderstanding. Take shareholders. They're all very different. You can't expect them all to look at the processes in a big company with the same scrutiny, the same alertness and acuteness of observation as analysts, auditors and other professional specialists. They can't do it; they're simply too far removed from the actual situation. Perhaps we should indeed return to trust. As a shareholder you must be able to trust that the members of the managing and supervisory boards will be able to carry out their responsibilities.' That brings us back to the observation that integrity is not something that can be taken for granted. Trust implies, after all, a degree of uncertainty. 'We started our conversation with the proposition that you know you can't actually count on it, but you still hope... It's often not there, and yet we still say that's how things should be. Apparently, both observations are true. That's the reality we live in. You can draw the conclusion from that dilemma that relying on trust won't work, and so you will have to lay down strict, watertight rules. You can then make the result public, and let the world pass judgement on it. But then you're presupposing some sort of invisible abstract mind or conscience – but I don't believe it works like that.'

A copy of your passport, please

Then how does it work? 'A good example occurred when the Identification (Financial Services) Act was passed in 2006,' relates Schilder. 'This law required

banks to check the identity of their clients, so that they can be sure who they're dealing with. One way they could demonstrate that they'd done their duty on that point was to check the client's passport and put a copy in their files. But the compliance departments could see problems looming – how could they possibly do this with all their clients? What about people who lived too far away, or were difficult to get in touch with? We explained that we hadn't stipulated exactly how they should check a client's identity, simply that we might ask them at some point to explain what they had done to assure themselves of that identity. But the banks were still worried. So we got their representatives round the table, to see what exactly the problem was. It turned out that, in the case of most clients, checking and copying their passport was no problem. The difficult ones were those who, for some reason, could not or would not actually come to the bank's offices. In such cases, you have to use common sense: you can authorise the branch manager to do things, for instance. So, on just a few pages, we then agreed some guidelines for dealing with the requirements of the Act. Certain categories were exempted; others needed special alerts. It didn't take hundreds of pages, only three. The panic and frustration disappeared. Job done.' What you can conclude from this, says Schilder, is that rich or complex material can often be reduced to the simple question 'What is it supposed to achieve?' 'Then you just need to agree some common-sense rules about that. And don't carve them in stone, because you may want to do things differently in a couple of years' time. Of course, there will always be things you don't agree on. But with mutual respect and trust, you can still get closer to each other. If you know how things work, and you're prepared to listen to

each other, then you'll often find a solution. That means a lot of homework. I'm not saying it's easy – it's a real profession.'

Ensuring that the message arrives

So it's back to the old days? 'The advantage of the old days was that directors and everyone around them explicitly said, "Wait a minute, let's not count our chickens before they're hatched. We know things can go wrong, so let's keep some reserves." Of course, if they said that too loud, shareholders would jump in and claim these reserves as their own: we've seen what damage shareholders can do just this past year. Now we're seeing several banks becoming state-owned, perhaps it's time to re-examine a few things, and ask ourselves as a society how we're going to arrange them in the future. We're getting a totally different situation, because government is now the majority shareholder, and accountable to parliament.' In the old days, whenever transparency might lead to unrest or problems, it was dispensed with. Is Schilder recommending a return to that situation? 'No. Of course, that's not an option. One-way communication is not really communication at all. But whenever you have to communicate something, you need to have a very clear idea of why you're doing it. Communicating involves making commitments for which you can be held accountable. And whether you're communicating to an internal or an external audience, you need to think carefully about which of the many media offered by society today will get your message across most effectively. In essence, you want to be accountable for behaving in line with reasonable social standards. You need to understand what's expected of you in terms of fair dealing, and you have to make sure

'You just need to agree some common-sense rules about that – and don't carve them in stone, because you may want to do things differently in a couple of years' time'

that you stick to that. It's a vague, open, broad field: maybe we shouldn't want to pin it down too much.'

Don't preach

Mutual communication also forms an important part of Schilder's work. 'At least, I'm very much involved with it. If somebody wishes to talk about something, I make time for them. I'm particularly careful about how I communicate – I believe that's very important. I certainly don't want to preach to someone about what they should do or how they should do it. I suppose I tend to be a bit of a businessman and a bit of a clergyman. Not surprisingly – after all, I was trained to be both.' How does the combination of those two approaches work, in one and the same person? 'I studied Theology, specialising in Ethics,' explains Schilder. 'But as time went on, I found it too abstract and too divorced from society. For a while, I taught Social Studies at high school. Then one day I suddenly thought, 'Here I am, telling children about rules in society, about the levelling of income and that sort of thing. But what do I really know about such matters? So I decided to train to become an accountant. And it really turned out to be "my" subject. Some of my friends saw it as betrayal. They're entitled to their opinion, but personally I'm glad that I no longer have to just stand on the sidelines. The great thing about my job

‘I suppose I tend to be a bit of a businessman and a bit of a clergyman’

at DNB is that we were always automatically involved in any ongoing social and political debates, such as executive remuneration policy or the position of the new state-owned banks.’

Healthy risk management

What can we learn from the financial crisis? ‘I think that’s still a premature question. We haven’t yet got the required distance to be able to survey the whole field. But there are two basic lessons we can learn already, I think. First of all, even if the intention is to provide housing for the poorer members of society, you should not be tempted to organise things in such a way that healthy risk management is neglected. In America, I met mortgage lenders who told me they were under pressure to fulfil the political ideal that every American family should be able to buy its own home. That situation led to banks and insurance companies offering innovative financial rates, while ignoring sound risk management. Later, due to modern communications technology and innovative practices,

these spread rapidly around the world and quickly developed into a closed world of their own, which no one fully understood in time. The moral is very simple. First the level of reliability that we could once expect of risk management at a bank has been lost. Second, we’re now seeing debates starting up again about balancing the pursuit of shareholder value with utility, about remuneration rules and advertising rules – a general testing of the rules of the game. Why are there banks in the world? And who are their real principals? And because we now have state-owned banks, that discussion is basically everyone’s discussion.’

Arnold Schilder is Chair of the International Auditing and Assurance Standards Board (IAASB). He is also part-time professor of Auditing at the University of Amsterdam. Before taking up his present position with the IAASB in 2009, Arnold Schilder was on the Managing Board of DNB, the Dutch central bank, where he was responsible for regulatory and supervisory matters.

