‘No single individual feels responsible for bringing the system down, but ultimately it’s the banks that are collectively responsible’

Lately, Morris Tabaksblat, like many of his colleagues, has been very occupied by the credit crisis. To understand the causes of the crisis, he says, we need to look back to the earliest days of banking. ‘It seems as though, over the past few years, everyone has forgotten that banking started with a system of *del credere*, or ‘trust’. Indeed, the word *credit* still refers to the trust that is placed in the ability of a person or company to pay. Therein lies the origin of the whole system – trust in the ability to pay. The Italians set up that system, with banks that served the whole of Europe from Florence through the representatives they had in towns or villages. They made sure that money flowed, and it worked very well. It was all based on trust. And now that trust has been completely lost.’

This must never happen again

That leads to two conclusions, says Tabaksblat. First, that trust must be restored, and, second, that measures must be taken to prevent such a crisis of trust ever happening again. ‘This is vital from a social point of view,’ he says. ‘Of course, it *will* happen again – you have to be realistic. Nonetheless, we must do our best to prevent a reoccurrence. Personally, I think a good deal more regulation is needed. Not that governments should take over tasks from the business world, but they do need to ensure that the checks and reporting are much better; and we will need to regulate more intelligently what we’re going to allow, and what we’re going to forbid. After all, there had certainly been warnings about the risks of valuing at “fair value”. Despite those warnings, it was pushed through in Europe purely because the Americans were also doing it.’

The story

‘I don’t think the system went wrong so much because mistakes were made or rules deliberately flouted,’ says Tabaksblat, ‘but rather because the system encouraged ill-considered behaviour. Banks made and sold products that were too complex. That was encouraged, and led to irresponsible behaviour. Those who sold more were rewarded with big bonuses, sending all the wrong signals. As a result, people started selling products they didn’t understand – which was totally scandalous. They failed to foresee the effect that this would have, an omission which itself is absolutely reprehensible. And to top it all, the products were not always the best solution for the customer in the first place.’ In fact, he points out, customers play only a very marginal part in the whole story. ‘Bankers forgot about their needs. They ignored the consequences the risks they were taking could have for their role in society. It’s not that they deliberately acted badly; they simply forgot about the risks. That in itself shows a lack of integrity. They weren’t critical enough.’

Astounding

That uncritical attitude runs completely counter to the whole system of risk management that companies had been talking so much about. ‘Somehow or other, people managed to circumvent the checks and balances in the system. The scale on which that happened is astounding.' Tabaksblat can only ascribe it to some sort of copycat behaviour. 'At a certain point, people think, "Well, if one bank can do it, then we should be able to do it as well." That is, until the risks become so enormous that the system collapses. No single individual then feels responsible for bringing the system down, but ultimately it's the banks that are collectively responsible. It's clear where the guilt lies: it lies mainly with those who took the risks. And that's why the whole situation raises a lot of doubts about the professionalism with which such matters were guided.'

That pressure of time

That lost trust will be restored only very slowly: it may take a long time. What should be done in the meantime? 'As the old Dutch saying goes, "Trust comes on foot, but leaves on horseback",' says Tabaksblat. 'Well, trust in the financial system has galloped off faster than we could ever have expected. Restoring it will take many years. In the meantime, we have to get the system going again. And we can only do that by providing certainty. We need the kind of absolute faith that only external checks can give.' The big banks, he thinks, are no longer able to deliver that faith, at least not anytime soon. 'And I don't see many other options. You could do something, either temporarily or permanently, in the area of regulation; but the whole regulatory system needs to be overhauled. We need to go back to the rules of post-1929; they worked well for a very long time. We now need to ask ourselves how it was possible that things still managed to go wrong, and then make sure that those rules work better. I don't think the government is giving itself time enough to make the sorts of analyses that are required. So the sector will need to do the job itself. Unless the banks

themselves come up with ideas and solutions, you won't get fewer, more efficient rules; you'll just get more and more rules.'

Learning from the old, going with the new

The only way to arrive at the right measures is to undertake an in-depth analysis of the crisis, says Tabaksblat. And the right measures will be far-reaching. The only way to prevent a proliferation of rules, he believes, is for the financial world (i.e., the banks and insurance companies) to set to work themselves. 'They'll need to show that they're re-examining their systems and are striving to get their house in order. But they'll need to get moving very quickly. Now that we're being swept along on a tide of nationalisation, more rules will be the inevitable result as governments try to get the system re-started.' Tabaksblat argues for a phased approach. 'First, some new rules will be needed to get the system going again. Then, in the meantime, we can work together (with the initiative coming from the sector itself) to decide how we can get the system in proper order again. Let's hope that, once the crisis is over, people will dare to replace the patches that we applied to get us through the crisis and go with a new system. But I'm afraid we shouldn't be too hopeful about that happening.'

Professionals

Where exactly did the problem lie? Tabaksblat has strong views on this. 'I believe one of the main problems was a remarkable lack of professionalism at the top. When the CEOs of the big American banks appeared before a Congressional committee and admitted that they didn't fully understand what a subprime mortgage was and what its full implications were, it was almost unbelievable. These mortgages were not minor products. On the contrary, they involved major risks – risks that (as we all now know) were capable of bringing their banks down. So how could they possibly not know what they were? If they didn't, then it reveals a chronic lack of professional managerial skills on their part.'

Who needs to know what?

Tabaksblat makes a clear distinction between the executive directors, who run the business on a day-to-day basis – i.e., as members of the board of management – and those who supervise and advise their activities – the supervisory board members or the non-executive directors. 'The executive directors more than anyone need to know their own products inside out and backwards,' says Tabaksblat. 'They're the professionals. If they don't understand, how can anyone else be expected to do so? But I'm afraid that there's often a lot they don't understand: they leave it to their experts and hope for the best.' Supervisory board members and non-executive directors, however, can't be expected to know as much about day-to-day matters as the board of management, says Tabaksblat. 'Nor can you expect them individually to have all the knowledge required to supervise the board of management. But they should – together – have the right depth and breadth of experience and knowledge to fully understand how the organisation is placed, each contributing his or her own specialist skills to the pool required to provide effective supervision.' There should, for instance, be a good lawyer, he says, to ensure that the public interest is being properly safeguarded, and also (in the case of a bank) a professional banker, who, thanks to his experience and understanding of the business,

‘You have to learn about the whole process – and the same goes for bankers or insurance people’

can explain to his fellow supervisory board members the technicalities of banking and financial products, and can foresee their implications.’

Dropping out

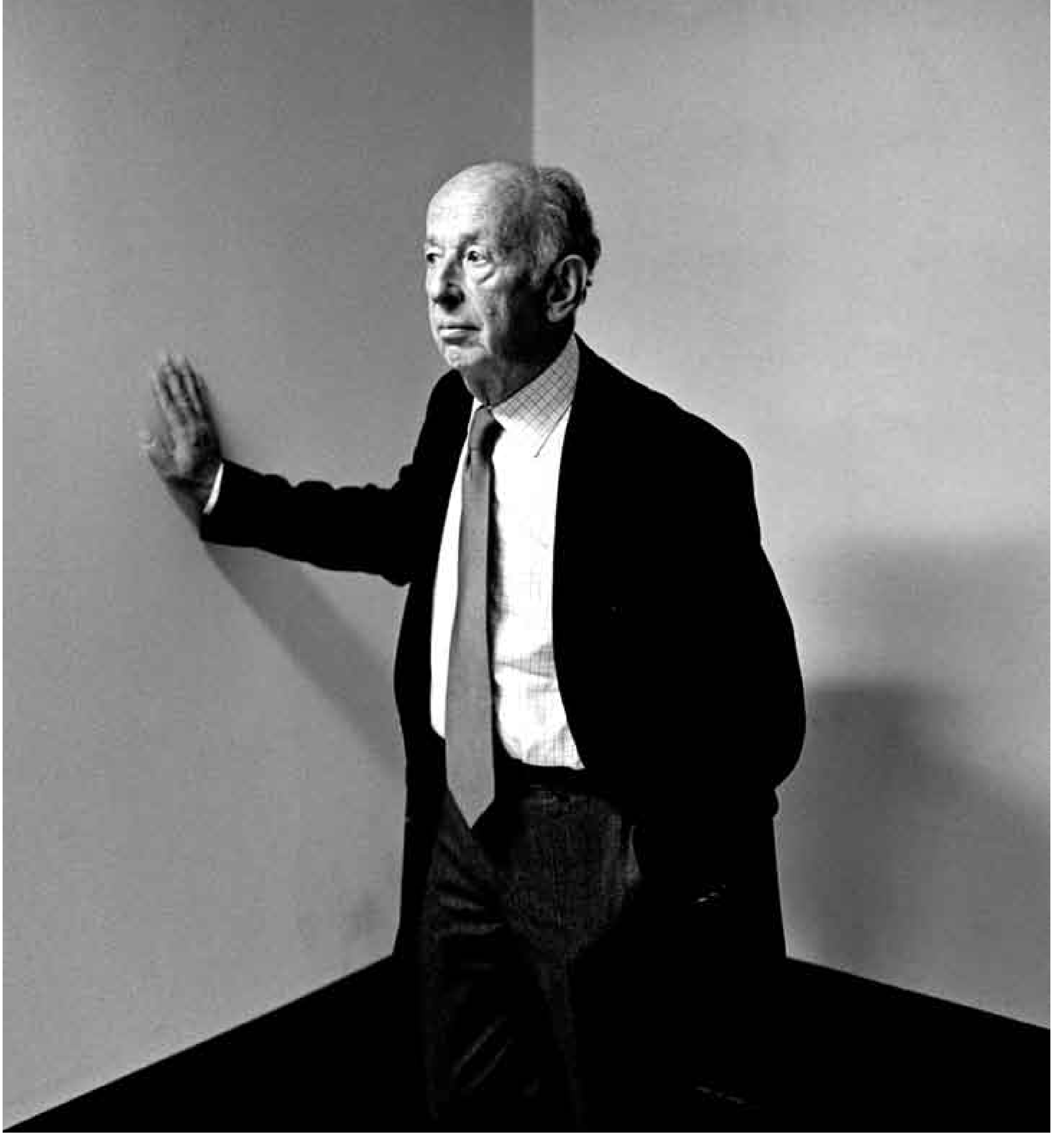
‘To illustrate how useful such technical expertise can be on the board, take the annual meetings with the actuary at an insurance company,’ says Tabaksblat. ‘Such meetings are often very difficult to follow (and to chair!), because most supervisory board members don’t really understand the mathematical models that actuaries use, and therefore drop out of the discussion at a certain point. Some actuarial expertise within the board itself would be very helpful in such cases.’ In practical terms, he says, this means that, when there are vacancies on their supervisory board, companies should try to find candidates with the specific knowledge and special skills they need. ‘That way, you improve the quality of the whole board.’ But supervision is a secondary function,’ emphasises Tabaksblat. ‘The primary function lies with the board of management, We should be demanding a higher level of professional competence from them, because that was clearly what was lacking at the banks.’
‘When there are vacancies on the supervisory board, companies should try to find candidates with the specific knowledge and skills they need – that way, you improve the quality of the whole board.’

Getting intimate with the company

Tabaksblat is convinced that the role of the supervisory board is set to change. ‘In fact, its role is already changing, and I think the Corporate Governance Code has had a lot to do with that. Supervisory board members and non-executive directors have to become much more involved with their company. They need to devote a lot more time to the job, too. They’ll have to travel around a lot, and not just meet occasionally at company head office.’ The supervisory board, he says, needs to become more intimate with the company, talking not just to the board, but with other employees, as well as with clients and suppliers. ‘That way, as you walk around, or observe people’s body language during meetings, you pick up important signals about the state of management, spotting potential problems before they can take hold.’

Getting out there

This active approach is very different to the one traditionally taken by Dutch supervisory boards, says Tabaksblat. ‘They’re much more advanced on this point in Anglo-Saxon countries. A good example is General Electric, where Jack Welch and his fellow board members would decide to spend a number of days a year at particular branches – and not always the same ones! They would walk around in pairs. They would decide for themselves what they wanted to see and who they wanted to talk to. Afterwards, they reported back to the group. Many companies do that on a regular basis. And that’s a very good thing.’



Working from an office

Such initiatives have to be taken at the highest levels, says Tabaksblat. 'The chair of the supervisory board should arrange to have an office at the company. It doesn't matter whether the company has a one-tier or a two-tier board. The chair has to have a place to operate from, and then be left to do his job. I have chaired three supervisory boards: Elsevier, Aegon and TNT. I had an office at Elsevier, but not at the other two – which was a considerable handicap, because you have to arrange many more things by phone, and every time I came in, I had to report to the porter at the gate and wait to be vetted. I also had to make sure that the people I wanted to talk to were there. At Elsevier, I was simply on the spot. The people I wanted to talk to had to make sure they were there, and not the other way round. I was free to take initiatives myself. I made lists. I talked to the CEO about what I'd been doing, and the conclusions that I'd drawn. And we'd discuss them. It was excellent. However, it does take time, of course. If you develop the job in this way, you'll only be able to sit on a few boards.'

Persevering and testing the direction of your goal

Back to integrity as the ethical foundation: 'Integrity,' says Tabaksblat, 'is monitoring that the goal that you've agreed with each other can be reached in the agreed manner. You have to make sure that you keep moving towards that goal under all circumstances. You need to test every deviation from your course against what was originally decided. In this way, you maintain integrity throughout the company, because everyone knows what the goal is. And everyone also understands why you're testing the way you are doing it. Of course, integrity is an ethical concept, but it's also, in essence, a management tool. This is because it's very important that the company's objectives have been discussed with everyone in the company, so that they can fully identify with them.'

Morris Tabaksblat chaired the committee that developed the Dutch Corporate Governance Code (also known as the 'Tabaksblat Code'). He was formerly CEO of Unilever and non-executive Chairman of Reed Elsevier International.