

# **“DON’T WASTE A GOOD CRISIS”**

**BY: HERMAN MULDER**

**FORMER DIRECTOR-GENERAL, HEAD GROUP RISK ABN AMRO BANK; BOARDMEMBER OF GLOBAL REPORTING INITIATIVE (GRI)**

**FOR: “RESPONSIBLE GROWTH - THE ANSWER IN A TIME OF CRISIS” CONFERENCE**

**COPENHAGEN 14 MAY 2009**

**LADIES AND GENTLEMEN,**

Don't waste a good crisis: it is a challenge, it is pain, and of course with many losers. But it should also be seen as an opportunity: to revitalize and even reinvent ourselves, to sharpen our fundamental values, to develop new priorities and opportunities, to build new coalitions. My objective today is to offer you my views as a former banker and risk manager who failed in his previous core mission.

**TODAY'S CRISIS: lessons learned, promises made, promises kept?**

Every crisis is unique, as it will have its particular causes, triggers, its lasting impacts and learnings. Every crisis necessitates us to repair the damage, correct the failures, punish the guilty, make solemn promises and taking steps to prevent it from occurring again. That is what is happening today, including at the last G20 Summit in London.

However, the history of crises suggests that once the crisis is over (this one in late 2009?), we tend to forget and become complacent. Even worse, the solution to a current crisis often creates also the conditions for the next one, usually entirely different in triggers, more complex, even bigger in terms of scope, scale and effects. And today's antidote, anti-deflationary measures, adds to this by creating, over time, hyperinflation and/or new "bubbles" (as we have seen before).

The reason for this is that the focus on managing the crisis-at-hand is putting mostly financial- economic remedies into place, and is hence causing us to pay less attention to other, often already well-known, but not so deemed urgent issues which subsequently become the root cause for the next crisis. Typically, it takes a major, deep, long-lasting crisis to complete fundamental reconstruction needed after the fire-fighting during the previous crisis. Short crises are often "wasted": the current one should not!

In the today's environment, the focus on restoration of the financial system and stabilization of the global economy by applying stimuli to deal with the recession notably in USA and EU, is causing, inter alia, significant pressure on public finances (with impact for many years to come) as well as calls for

measures to protect domestic employment and protectionism, which will particularly go at the expense of low-income countries and the natural environment.

What began as a financial sector crisis and subsequently became a broader economic crisis, may well develop into a global, de-stabilising social, humanitarian and environmental crisis.

On a macro-level the response and follow-up on calls for (1) a much more inclusive international governance architecture (notably the Bretton Woods institutions), (2) strengthened, counter-cyclical development assistance/ODA (Monterrey/Doha), (3) a fair, forward-looking result of the Doha Trade Development agenda (WTO), and (4) a comprehensive, global, long, loud and clear Climate Accord in December here in Copenhagen (with major funding commitments for Adaptation for the vulnerable South), all hopefully to be effected in 2009, may well be disappointing because of lack of consensus and political will, either in its negotiation results or, even more likely, in its implementation. Moreover, the targets of the MDG's for 2015 will undoubtedly be missed by some 5 years as a consequence of the current recession (poverty alleviation in particular), while climate change, serious dislocation of fresh water resources, ecosystems' degradation and bio-diversity loss will continue, even accelerate.

This is a problem which needs to be addressed with importance and urgency, as the consequence of too little, too late action will result, without a doubt, in explosive situations, with eg. "the global poor" standing up against all elites, both domestic (also in eg. Shanghai, Mumbai) and on a global scale, affecting strategic resource availability and supply chains in our globalised, interdependent world, increased migration and even conflict: the "Perfect Storm of October 2015", as crises often manifest themselves in October, and in the 7<sup>th</sup> (Jubilee) year after, i.e. 2015. It may be in scope a combination of Malthus and Marx, global in its scale, and very difficult to manage, resolve and even to contain. "Si vis pacem, para bellum": addressing and preventing this early (i.e. now) in a responsible and effective way by us (the elites) is not just a matter of an ethical imperative for public and private sectors, but even more, of long term self-interest.

On a more micro-level, the call for better regulation, supervision, governance, business principles, accountability and transparency is meant to rebuild trust and to change the financial sector players to show a much more "society-responsible" behavior. Also here, the jury is out how lasting these measures will be, as in the process of rapid deleveraging, recapitalization and cost-cutting, the wrong business-as-usual may be conducted, rather than the preferred approach to be a leader in the public agenda of climate, clean energy, nature conservation, poverty alleviation, justice. Business cannot survive in failed societies.....: no people, no planet: no profit!

### **THE LONDON G20 SUMMIT: "Copenhagen, we have problem"**

The G20 Washington Declaration & Action Plan of mid November 2008 was (rightfully so) very much focused on stabilizing the financial system particularly in US, EU and on supporting economic growth: a loud, collective and concerted action plan was highly needed. The principles of reform agreed included: (1) strengthening transparency and accountability, (2) enhancing sound regulation, (3) promoting integrity in financial markets, (4) reinforcing international cooperation, (5) reforming international financial institutions. Strengthening transparency and accountability focused essentially on accounting

standards, risk management practices and the disclosure of risk exposures, including off-balance sheet activities, by financial institutions. All of this is important and requires urgent addressing, and was followed up at the G20 Summit in London early April this year in “The Global plan for Recovery and Reform”.

However, this Plan has as main focus the immediate economic, employment and institutional issues, but it is falling short on offering a perspective, as a minimum, on the medium term, broader global agenda, with environmental degradation and continued rampant poverty as major, geopolitical destabilisers for, literally as we speak, tomorrow. There was no reference to the “Global Green New Deal” or “Justice for Everyone”. Climate change was mentioned in a way as if it was an after-thought. It also did not appeal to more multi-stakeholder approaches, to include business, civil society organizations and academia, suggesting that many governments still believe they have all the answers. In other words, “Copenhagen, we have a problem”. So how to address this efficiently and effectively?

### **GOVERNMENT REGULATIONS OR BUSINESS VOLUNTARISM: fit for sustainable purpose?**

The current financial and economic crisis has shown again, and probably more than ever before, how globalised and interdependent our world and societies have become. The fall-out of the banking crisis in its scope (real economy) and scale (globally) is surpassing our worst scenarios and fears. As a former banker and risk-manager, I can attest that my colleagues and I did see different “beasts” which could hurt us, but we didn’t expect the “whole zoo” to revolt. Clearly, Murphy is living one his finest hours.

Interestingly, the banking sector was one of the most regulated and supervised sectors, and its core business is risk management. So isn’t it amazing that the interbank credit markets came in late 2008 to a complete halt because the professionals didn’t trust each other anymore? So much for prudent risk-policies, -positions, -supervision and the transparency thereof. We got it all “sensationally” wrong, as no one (policy makers, bankers, rating agencies, auditors included) saw the systemic nature of a financial crisis coming, neither in scope or scale.

Also, the banking community was during the last 10 years actively involved in an interactive process with regulators and supervisors, to improve risk management practices through “the Basel II process”, which now is clearly been tested because of its designed limited scope (banks-only), its reliance on i.a. rating agencies and as yet untested financial models, as well as underestimating liquidity risk and its pro-cyclical effects. However, the fundamental structure of “Basel II” already recognized the complexity of understanding and managing risk in its complementary governance structure: Pillar 1 with self-discipline by banks, Pillar 2 with supervisory review, Pillar 3 with market (=stakeholder) discipline.

Simultaneously, in the banking financial sector (and beyond) various ESG-principles (environment, social, governance) as well as disclosure codes of conduct have been committed in individual countries and also internationally, like the Equator Principles for project-financing banks, the Principles for Responsible Investment (PRI) for long term investors and asset managers, and GRI (Global Reporting Initiative) for advanced non-financial reporting. And although such voluntary codes of conduct are proving their value, much more needs to be done

Standards'-setting in regulations and/or codes of conduct is important but in an increasingly interdependent, yet very diverse world in terms of such norms, difficult to harmonize. Thus, multinational corporations are faced in many different countries they are active in, through direct investment and/or value-chains, with different, often lower standards. Such multinational companies are typically expected to apply "best practice", with their home country as benchmark, across the world, sometimes causing an un-level playing field with local companies or competing international companies from the South, particularly where strategic commodities are in play. International agreements to widen the scope of eg. the OECD Guidelines for Multinational Corporations or the Global Compact principles are warranted. Government monitoring and grievance procedure should strengthen the compliance herewith.

For future reference, a big question is also what type of frameworks, checks & balances valuation-methods are "fit for purpose", i.e. addressing high risk factors in an early stage and offering a fair value of assets, liabilities, companies. What is better: ticking-the-box compliance with across-the-sector(s), uniform, specific rules or voluntary self-defined principles fit for purpose for an individual company or bank with the performance thereon publicly disclosed. The later may have too little "teeth" but are more tailor-made, and offer more flexibility in a dynamic world, as well as "ownership", and clear accountability; the former comes with more "teeth" but may be too general and dated, apart from being imposed indiscriminately by the (qualified?) regulator/supervisor.

There is no uniform answer, but the 3<sup>rd</sup> way may be (1) "mandatory self-regulation on standards", required by regulators but offering each business (including financial institutions) the space to define such self-discipline, in process, content, direct and indirect impact, fit for its own franchise, and (2) "mandatory reporting on financial and non-financial risks" (and opportunities), such as Denmark, Sweden, Norway are now requiring. It would create a much more comprehensive, comparable risk – perspective to public and private sector stakeholders, also in the context of the global public agenda.

#### **ACCOUNTABILITY & TRANSPARENCY: effecting urgently needed, fundamental change**

All stakeholders, whether voters, employees, customers, investors/lenders, partners, supervisors need to be able to assess the risk- (and opportunity-) profile of a government or company. Public reporting by government (on basis of traditional GDP) as well as business (value, profit per IFRS) in its present form is essentially addressing, measuring and valuing the financial-economic dimension only. It does not address in a systematic, assured way the emerging, critical non-financial issues, such as environmental and social performance, particularly in a world increasing scarcities, changing the price-paradigm, and having major value-impairing/liabilities or -enhancing effects/opportunities .

A "Global Green and Fair New Deal" will emerge in the years to come, inevitably: by "pain" (to gain) or by vision, out of risk management as well as by opportunity. The "Green & Fair Economy" with millions of new green jobs and will become reality. There are in such world no "externalities" anymore, polluter-/user-pays-full-price has been effected, as we have repaired our defective economic compass adopting the concept of Natural and Social Capital, taking into account the environmental and social costs and income/benefits. In this triple context I would like to refer to the EU/FRG/UNEP **TEEB Study** underway:

“The Economics of Ecosystems and Biodiversity” ([www.TEEB.ufz](http://www.TEEB.ufz)): its objective is to create a methodology to value our global ecosystem and biodiversity, i.e. our Natural Capital, to subsequently the groundwork for a practice of payment-for-ecosystem-services (PES)

To effect this, performance targets and public disclosure thereon should become explicitly part of the required internal discipline and systems, and the external accountability by all key players in society, whether national, local governments or (large, medium, even small) business and others. We should set the stage for this on a global basis, both in public and private sectors: the public agenda is too important and urgent to leave it to voluntary, local initiatives-only. The **Global Reporting Initiative (GRI)** is the leading, most advanced and accepted global standard and incubator for such “new” reporting. Sweden, Norway, Denmark are showing excellent leadership to require advanced reporting on non-financial items, with GRI as reference.

The current reality has also underscored the importance of the “action-drivers” and the underlying values and principles: traditional purely profit-driven capitalism has led to excessive compensation schemes, usury lending practices, next to human rights violations, wasteful use of old and “new” scarcities, irresponsible degradation of eco-systems, all examples of behavior which needs to be exposed and corrected: they undercut the fundamental values we all stand for or aspire to.

We are living in a world with a diversity of cultures, religions, interests, skills, resources, etc. The world needs to intensify the dialogue on what core values we have in common, both in the public or private sectors. Also here the recent G20 Summit has failed to give a loud signal for defining, possibly under the UN banner, a comprehensive set of global core principles. The OECD Guidelines for Multinational Corporations are in this context an important reference.

### **ASPIRATION, ACTION & TRACTION: restoring trust & credibility; enhanced accountability**

Inuits know that the best fishing is during a storm. Pain is often the best driver for change and subsequent gain. So this is the moment to lay the foundations for a better, inclusive, sustainable world based on social justice, environmental stewardship, economic stability, embedded in an open structure with much improved accountability and transparency.

In setting this aspirational goal we should make no assumptions: too many commitments in the past have not been met, affecting the credibility of notably international organizations and donors: over-promising and under-delivering has been the “norm” for too long. Likewise, the intended or unintended impact on environment and communities of interventions and/or investments have often been insufficiently taken into account. Underlying values and principles are often not explicit, hence not communicated and causing misunderstandings and conflicts with affected stakeholders.

We need to respect but also manage diversity: such concerns bio-diversity, cultures, skills. But another type of diversity is a concern: the lack of consistency and cohesion within governments among different branches needs to be effectively addressed; this notion is also true for international institutions.

Moreover, more multi-stakeholder fora need to be created for business, civil society organizations, academia to contribute to consistent, effective, enabling government policies and regulations. We need to publicly declare what we intend to do and why, to do what we so declare, measure what we so do, and be accountable in an open and professional way with our relevant stakeholders: market democracy.

We may only effect this if we disclose, professionally, consistently, openly, and comparably, enabling an interest-holder to engage. For this we need generally accepted frameworks for operating- and disclosure standards, which are “fit for purpose”. And the business sector should become particularly engaged: from “business and society” to “business in society”. Business is not getting its legitimacy and creating its value by believing it is “making a profit” in isolation, rather it earns its value off all its stakeholders. Business is part of society and must hence include, even embrace the public agenda into its business policies. Sustainable development, responsible corporate behavior, including respecting human rights, ought to be, even more, part of core business.

We have entered the Age of Sustainability & Accountability, because of the reality that more people need to share scarcer resources of our planet. Governments now have the opportunity to “impose” themselves on themselves, on civil society (incl. consumers) and, foremost on business, including the financial sector (not only in their internal, housekeeping, but also in their client-engagement), to explicit adopt, effect and disclose sustainability policies, monitored by supervisors and civil society on the basis of adequate reporting.

An interesting driver of “greening” the financial sector relates to the “exit” by governments from failed big banks, automotive and other companies in 3-4 years, by selling their interest to strategic investors at best value must ensure that such banks and companies already now adopt the policies which are fit for 2015-2020!

The worst aspect of the current crisis is the loss of trust and respect in our institutions, its leaders and the experts: a moral and managerial crisis, as the financial crisis affects so many so deeply.

The G20 Summit in London intended to restore this loss of trust, however it seems foremost have been driven towards more regulation by governments, by self-interest among countries rather than emphasizing human solidarity, social justice and serious concern about the limits to the “regenerative capacity” of our ecosystem. Accountability and disclosure lead to more trust which is crucial for societies to be well-functioning, particularly in challenging times like these days.

None of us knows all the questions, let alone the answers or the “silver bullet”. It is a constant learning and communication process. The concept of complementary governance in a complicated, unequal world living on a planet-at-risk requires individuals to take responsibility, give respect, earn trust: this can only be done by informed and engaged participants.

For advanced governments, business, civil society organisations, this is the moment to be seized to fully exercise their public duty and exploit heir convening power to facilitate engagement, action & traction throughout society towards a green economy, a just society and economic stability. The future starts now, with YOU and me.

## **IN CONCLUSION: multistakeholder value creation and mandatory reporting**

Our problems and challenges are daunting, the solutions are in principle scientifically, and technically available, but reconciliation of the diversity of preferred options is our biggest challenge, for which coalition-building and complementary governance between stakeholders such as smart governments, sustainable business, engaged civil society organizations and integrated science by academia are of the essence. Mandatory measuring and reporting by business on environmental, social and governance (ESG) issues is in this context of the essence. “Mandatory self-regulation” on business standards and financial and non-financial performance is the key driver behind this. Don’t waste a good crisis!

THANK YOU