

A Crisis of Trust

By Lorne R. Armstrong

§ A financial crisis is making headlines but the financial mess is the fallout; not the real crisis. The financial crunch is not likely to be the most significant fallout; the real crunch is a trust crunch.

The financial foolishness is clear. In a drive to continuously increase profits, banks lend more and more mortgage money to people who can least afford to pay. They lend more than the underlying assets are worth; they lend more than borrower's incomes justify; they structure the lending with low initial payments that rise quickly. Then they sell these mortgages to financial institutions (Bear Sterns, Lehman Brothers, et al) who, in turn, repackage them, call them high grade investments (as confirmed by the rating agencies), and sell them to their clients. Some of the documents describing these investments and the associated risks run upwards of 700 pages.

The repackaging included "credit default swaps" that in turn were traded on the market. Purchasers are led to believe that this credit default swap protects them – pays them, if people default on the underlying loans. We might be tempted to think of this as insurance, but these are sold as "swaps" not "insurance". If they were sold as insurance, the seller would be regulated and have to demonstrate sufficient financial reserves to pay in the event of a default. Because it is called a swap and not insurance, there is no regulation and no need for the seller to demonstrate that they could actually pay in the event of a claim.

It doesn't take a genius to recognize the house of cards: risky mortgages rapidly churned out in a fantasy of a never ending increase in property values, repackaged in obscure ways, rated as low risk, combined with illusory insurance and sold to "trusting" clients by institutions with insufficient resources to withstand a crisis of trust.

We will never really know, but their financial modeling likely indicated they could withstand market slowdowns or the odd hiccup in cash flow. Clearly, and tragically, they did not factor in a crisis of trust.

TRUST AND DISCERNMENT DETERMINE YOUR LEADERSHIP CAPACITY

The lesson here is clear. Trust is essential to leadership; trust is essential to accomplishment; trust is essential to staying in business. If there is insufficient trust – with colleagues, "bosses" or those to whom you would provide leadership – not much of significance will get accomplished. Insufficient trust with clients, others in your industry or suppliers can mean the end of your business – even if you have been in business for decades and previously enjoyed a good reputation.

Lehman Brothers had been in business for 158 years, but folded because clients didn't trust them, investors didn't trust them and others in the industry didn't trust them enough to lend to them. After 85 years of trust, Bear Sterns clients lost billions, their shareholders lost billions and their employees lost their jobs. Merrill Lynch was driven into the hands of Bank of America when potential investors didn't trust that Merrill Lynch knew what it was doing. Insurance behemoth AIG couldn't be trusted to honor the \$441 billion of credit default swaps and investors didn't trust that AIG management knew the quality of their assets.

We are not very discerning in the area of trust and we often avoid talking about what do or don't trust people for. We are more inclined to talk about *whether* we trust someone or not – but not *what* we trust them for. We make trust an all or nothing deal. I trust you or I don't; you trust me or you don't. That isn't trust; that is foolish blindness that ultimately undermines trust. I may trust you to prepare a good meal but it may be foolish to trust you to run a restaurant. I may well trust that you have done a great job of analyzing the data but not trust that you are omniscient and have foreseen all possibilities. While I may trust that you have good and honorable intentions to turn your cooking skill into a national restaurant chain, it may be a foolish bet that you could do this with only cooking and analytical skills – no track record of leadership in building a business.

Development is irrevocably twinned with trust. Never be bullied by “don't you trust me?”, or “You'll just have to trust me on this.” Blind “trust” isn't trust at all. It is willful blindness – and no discernment. People can be trusted for what they have been developed to do – not more than that. Engaging with others to develop them in a particular area is worlds apart from deciding whether you trust them – for all things all the time – or not.

When you defer – without discernment – to someone else's judgment and recommendation alone, you are risking both the value of the transaction and the trust that has been built up over time. If someone plays the, *don't you trust me?* card when discernment and development is called for, it actively undermines trust. Never let others make something an issue of trust that is really an issue of competence, development or insight.

You are either taking action to honor and protect the trust that has been built in your relationships or you are risking it. Risk that trust at your peril. When people stop trusting you they stop believing what you stand for and what you have to say. When you gamble with your credibility you are gambling with your future and the future of your company.

Trust can take decades to establish and be vaporized in an instant.