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Financial Leaders Go AWOL in the Meltdown: Ben W. Heineman Jr.

Commentary by **Ben W. Heineman Jr.**

Nov. 4 (Bloomberg) -- Government leaders around the globe have dominated the economic and business news as they struggle with the credit, solvency and housing crises.

Where are the chief executive officers, top management and corporate directors of the world's financial institutions? Their failures, that familiar litany of excess leverage, indecipherable financial instruments, poor risk management and woeful compensation systems, are the main catalyst for these unprecedented problems.

There has been a stunning silence on private-sector causes and private-sector cures from the private sector itself. This is unconscionable, because their lapses raise profound political and economic questions about the balance between government regulation and corporate self-determination.

What's happening is a crisis of capitalism, though not because there is a debate about the ultimate virtues of capitalism over socialism -- that argument is long over. Rather, the failure of business leadership on an almost cataclysmic scale has brought front and center the issue of how government should rein in business. Governments around the globe that are addressing the impact of failed corporate decision-making also must deal with what caused it.

Even Alan Greenspan, a staunch advocate of free markets and no fan of regulation, acknowledged the problem: "I've been extraordinarily distressed by how badly the most sophisticated people in business handled risk management."

Unfortunately, Greenspan offered no suggestions about how companies should be managed in the future to avoid a repeat of the breakdown that, he said, caused him "shock and disbelief."

Facing Failures

In all good business organizations, facing failures honestly, looking at root causes, disciplining individuals and implementing systemic change to prevent recurrences is as important as planning for new products, markets or technologies.

Yet a voracious reader of economic and business reports would have a hard time finding a financial-industry statesman talking candidly about the errors and flawed judgment among managers or directors. Nor will you find a hint about how these private institutions should govern themselves in the future to avoid a recurrence of such widespread devastation.

Instead, the chairman of a failed investment bank testifies on Capitol Hill that he is responsible -- then blames everyone else. Financial CEOs at a session organized by the New York Stock Exchange call for more Wall Street tax breaks, repeal of the Sarbanes-Oxley Act and limits on class-action lawsuits.

To be sure, many actors have some responsibility for the current crises: policy makers, regulators, accountants, rating companies, imprudent consumers, quick-buck investors and the business-news media.

Performance With Integrity

But can there be any question that the root cause was the failure of financial-industry leaders to provide the balance between risk-taking and risk management needed for sound, sustainable growth? In short, there was a failure to fuse high performance with high integrity.

No one made these companies pile on leverage, create incomprehensible financial instruments, sideline robust risk assessment, fail to stress-test portfolios, assume housing values would only go up and award gargantuan compensation for churning paper.

Why did CEOs and business leaders so abjectly fail? Why did good corporate governance, which at its core is about checks and balances, fall short in financial services?

Obviously, public and government trust in industry decision-making has eroded. Now corporate leaders must honestly discuss their mistakes and propose how checks and balances can work before the slow process of rebuilding trust can begin.

Credibility Shredded

Some will say that this would mean admitting liability in a litigious society. But retired leaders or sitting CEOs in institutions singed by the crisis can surely find a way to discuss these issues without putting their heads in a noose.

Candor and realism about governance must be an essential part of the public debate about what limitations to impose on corporate decision-making. That debate will range from structural changes inside financial firms to procedural changes on issues such as disclosing off-balance-sheet liabilities to oversight of executive compensation.

In the immediate response to the financial and economic crises, issues left in the past to corporations are being addressed in a hurried, piecemeal way by government.

Business leaders' efforts to avoid regulatory change -- resorting to cries of “trust us” and “trust markets as they were” -- won't work. Too much credibility has been shredded for that, and the impact has been too severe.

Start Showing Up

The future of healthy, sustainable capitalism still turns on corporations' ability to govern themselves properly. This means balancing wealth creation and risk to drive performance with integrity, to have compensation systems that reward balanced growth rather than kowtow to greed, to respect customers and investors and to provide fairness and transparency.

An honest reckoning is a critical step in developing new regulations that advance the safety and soundness of our financial system. For that to happen, corporate leaders need to show up soon to talk credibly about the failings of the past and how to achieve the right internal balance in the future.

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