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On Leadership



LEGAL SCHOLAR

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THE QUESTION

Responsibilities of Profit?

Thanks to the government's rescue of the financial system, many banks and hedge funds are [making money again](#), but this turnaround has caused a backlash among recession-weary Americans. How should these business leaders respond?

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The Talented Mr. Blankfein

As stock prices and short-term profits rise for financial institutions, will business leaders follow their words of caution and humility uttered mere months ago? Or, despite near-death experiences, is the past now past and are the "good times," with all their flaws, about to roll again?

Exhibit A is Lloyd Blankfein, CEO of Goldman Sachs. Last year, Goldman was close to the precipice and was saved by a combination of government actions: injections of capital, debt guarantees and a fast-track thumbs-up of its wish to morph into a commercial bank.

In early April of this year, [Blankfein spoke to the Council of Institutional Investors](#), trying to get out ahead of a soon-to-follow grilling by Congress.

He was contrite about the causes of the financial melt-down that drove the global economy to the edge of depression:

Much of the past year has been deeply humbling to my industry. We held ourselves up as the experts and the loss of public confidence from failing to live up to the expectations that we created will take years to rebuild. Worse decisions on compensation and other actions taken and not taken, particularly at banks that lost a lot of shareholder value, look self-serving and greedy in hindsight...

we collectively neglected to raise enough questions about whether some of the trends and practices that became commonplace really served the public's long-term interests.

He spoke of the need for significant changes in the financial sector, saying, "Meaningful change and effective reform are vital and should naturally emanate from the lessons learned." He went on to say financial institutions must do a better job of managing operational risk; valuing assets more frequently; making risk and control functions independent of business units; and making compensation more closely correlate to the creation of economic value, adherence to a firm's management and controls, performance over years (not quarters) and results for the firm, not just for individuals.

In particular, Blankfein told the investors that significant portions of compensation should be deferred and individual performance measured over time "to avoid excessive risk taking and allow for a 'clawback' effect."

While properly defending the importance of private creativity and innovation to the growth of the economy, Blankfein also outlined the need for "more dynamic" regulation in capital, credit and underwriting standards; in the proper valuation of assets; in increased transparency (for hedge funds and private equity firms, too); and in increased global supervisory coordination and communication.

Of course, since that speech delivered at the beginning of the second quarter, Goldman announced profits of more than \$3 billion at the end of the quarter, much of it not from "proprietary" trading but as a market maker for bonds, currencies and commodities. So far this year, it has set aside more than \$11 billion for compensation (more than the first half of 2007 before the Fall) on the old pattern of roughly 50 percent of revenues. Goldman's share price is above \$150, a steep rise from its 52-week low of \$47.

Although Goldman is a stronger franchise than many other financial sector institutions, Blankfein was one of the few CEOs who spoke out candidly about causes and cures of the financial crisis. He is thus well positioned to speak out again to reaffirm what he said in April and to explain in detail how his ideas for private sector and public sector reform still apply today.

For his credibility and the credibility of his industry, he should reiterate in detail how the much needed "meaningful change and effective reform" of his spring speech are being applied at Goldman---and across the financial sector---in this summer, when the cotton, especially for Goldman, is high.

It is time for another speech to the Council of Institutional Investors. Or perhaps for another visit to one of the financial service committees in the Congress.

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