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## IS AVOIDING RESPONSIBILITY THE NEW FULL-TIME JOB?

It's time for the industry to begin learning from the financial crisis. And that begins with a gutsy decision

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Avoiding personal responsibility for the consequences of our actions is nothing new to the human condition. People have been doing it before the beginning of recorded history.

I can think of such disparate people commenting on this as Dr. Karl Menninger-who observed that people seemed to have lost any sense of sin-to General of the Army George Marshall.

Marshall, as President Truman's Secretary of State during the politically and morally corrosive "McCarthy era," observed that many seemed to hold him responsible for the poor morale within the U.S. Department of State. He said that while he accepted responsibility for his department, he asked plaintively, "Who is to be responsible for my morale?"

His conclusion as both soldier and statesman was that each of us is responsible for our own morale and accountable for our individual actions.

The oil spill in the Gulf of Mexico has produced its own spectacular display of finger pointing. And how many of us owned Ford Explorers equipped with Firestone tires a dozen or so years ago? "It's a design issue, Mr. Ford." "No, Mr. Firestone, your tires are the problem."

Banking surely has had its share of this. Samuel Armacost, CEO at Bank of America many years before the bank's merger with Nations Bank, told an interviewer from Fortune Magazine that he was amazed and disappointed that his executive group held him primarily responsible for the difficult financial condition that bank found itself in 20 or more years ago.

"I have a hard time believing that I was totally responsible for the condition of the bank," he said.

Armacost was not deflecting personal responsibility, but rather observing that the cumulative consequences of day-to-day activities of the executive management of the corporation, perhaps numbering 50 or so players, could hardly be laid at the feet of a single person.

Banking's hot potatoes

Nor is banking immune from this issue today.

What are the consequences of avoiding personal responsibility for the credit quality of our banks? Was no one in charge of loan review? Was there no documentation quality control or exception reporting? Were loan committees meeting without purpose, substance, or content during the last credit cycle? Did the boards of directors simply not know what was going on? Were they deliberately misled?

Objectively speaking, the financial results of the banking industry over the last two years demonstrates that industry affairs were seriously disordered. There are currently nearly 800 banks on the FDIC problem bank list. There have been 73 bank closures so far during 2010, with many more expected over the next several quarters.

If we can be reasonably specific about what went wrong, why can't we be reasonably specific as to who was responsible?

Three rocks to look under

I think that there are three urgent areas of inquiry to get to the heart of this question.

First is in the manner of governance. Are the boards of directors up to the job?

This is only in part a matter of individual directors' responsibility. A board is a collection of mostly part timers who have voluntarily associated themselves with a particular bank. They must be led by a small group of directors, including the CEO. This requires skill and determination. That it may not have been accomplished very artfully or very effectively is the starting point for corrective action. It must begin at once, bank by bank, if it's not already well underway.

Second, incentive compensation must be examined critically and clinically.

Is incentive compensation designed to reward bankers for performance above what is expected? Or is it in large part a prearranged and predetermined component of executive compensation? Are boards of directors incentivizing wrong behaviors?

The regulators have raised these issues in multiple ways already. It seems plain that much incentive compensation, particularly at the top levels of major banks, has been money poorly spent. The shareholders are ultimately responsible for correcting such conditions, but sometimes, bank supervisory authorities must intervene to produce constructive change and assure more holistic results for individual companies and the industry as a whole.

Without some explicit linking of compensation practices and accountability going forward, it's likely that much of the pain of the last several quarters will have been without purpose or effect.

Third, internal bank cultures should be examined to determine whether the culture failed the institution in whole or in part and what should be done about it.

While individual banks vary widely in the manner and types of internal cultures, there are some common themes. Appetite for growth in deposits, assets, income, and market share, together with insufficient controls on risk, are repetitive findings. The boards of directors must deal with this with the help of bank supervisory agencies. Governance and regulation are in a partnership for the common good, whether we like it or not.

Governance and regulation have to work in a complementary fashion. The corrosive relationships that have arisen between these two important constituencies is unfortunate and does great disservice to the banking public.

## Why responsibility matters so much

Banks and banking are essential to the smooth functioning of a modern economic society. In spite of what Congress have been doing, we seem no closer to real reform today than we have been since the repeal of Glass-Steagall and its replacement by Gramm-Leach-Bliley. The current legislative process seems destined to produce a political result than real reform in any systemic sense.

Communication, careful communication, makes a beginning. Due to matters of personal privacy, banks are generally reticent in their external communications with their various constituencies. We don't talk about our specific customers and we shouldn't. But we are sometimes insufficiently forthcoming about important matters. These are matters that don't necessarily reflect our legal and moral sensitivities and responsibilities on financial privacy.

We are, justifiably, concerned about reputation risk. A bank's liquidity is often directly linked to the perception of the depositing public on the bank's financial soundness. How transparent we as an industry should become is an urgent question and there's not a comfort level or generally agreement that seems to exist on what that might be. This area needs attention by managements and boards of directors.

One urgent place to start is to assign personal responsibility back into the process. Each of us must understand that actions have consequences and that we are truly accountable for what we do and what we say.

Absent accountability, a large portion of our industry is simply not earning its pay.

And I'm talking about the size of our paychecks before incentive pay.

About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear free audio interviews with Ed about workouts here. You can e-mail him at [etoleary@att.net](mailto:etoleary@att.net). O'Leary's website can be found at [www.etoleary.com](http://www.etoleary.com).

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