Reform and the Intellectual Chasm

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As the housing and economic crisis enters its third year, unfortunately much of the political and intellectual capital continues to be squandered on assigning blame, rather than dedicated to the true spirit of collaboration needed to produce realistic and long term solutions to the economic crisis that the nation is so desperately seeking. Far more productive than participating in a “blame game” that points fingers at institutions, politicians and regulators would be to identify and, if we must, blame a systemic flaw that has so far been given little attention. That shift in perspective and the insight it provides would yield productive reform and restore the public confidence in our nation’s markets. It would place the private and public institutions that have been the foundation of America’s greatness on solid footing once again.

This systemic flaw is the “intellectual chasm” - the professional, cultural and practical divide that has perpetuated a universal failure to fairly balance risk and reward for the benefit of the economy at large. It encompasses a myriad of dynamics, including, the timing and depth of knowledge, the allocation of resources to training, present notions of business values and ethics, and a system of individual economic rewards that fails to drive the evolution of a team effort that fosters sustainability and discipline alongside the entrepreneurial spirit.

Don’t confuse this intellectual chasm with intellectual capacity. We are smart enough to solve the problems that confront us.

The intellectual chasm plagues virtually every component of the system, including the private sector, the bureaucracy that regulates it, and political leaders and other stewards of the taxpayers’ money who lack a solid understanding of the underlying issues.

In the private sector, the financial crisis has exposed a gap between the practical knowledge base of corporate leadership and that of their business line managers (traders, brokers, investment managers, quantitative analysts, etc.). The crisis has also uncovered a failure to address that gap through individual self-improvement and cultivation of the depth and quality of talent needed to independently monitor business lines. Corporate leadership placed a premium on generating revenues (without dissecting their quality and future risk exposure), and those responsible for independently monitoring the related risks were relegated to second-class status.
Given that investment banking and global banking institutions for years followed a business model that allowed both strong returns for shareholders and a hefty bonus pool, there certainly was greater opportunity for parity in the compensation and reward structure for those that independently monitor risk. To properly balance quarterly performance and sustainable value for shareholders, the education, skill set, continued training and financial opportunities need to be more closely aligned. While top executives cannot be subject-matter experts for every business line, they should maintain a minimum knowledge base and both participate and facilitate in ongoing, face-to-face dialogues between risk management and each business line. This personal interface must be clearly documented and adhere to a disciplined schedule. But this doesn’t usually happen because most executives climbed the executive ladder through success in a single business line and, even in that arena, their accumulated expertise may have grown stale over time.

On the regulatory front, discussion has focused on reforming the regulatory framework to account for the systemic risk presented by institutions that are considered “too big to fail.” But true reform requires a greater focus on the quality of regulation rather than the quantity of regulators or the regulatory framework. The focus on regulatory framework is a top-down approach to remediation, whereas bridging the intellectual chasm requires equal focus on a bottom-up approach - where the rubber meets the road. Systemic risk is just another description of the intellectual chasm that allowed for the disconnect between regulation and market activities that festered to the point of a meltdown.

It is axiomatic that regulation lags innovation. The fix needs to be a regulatory architecture that works in tandem with innovation. This requires a proactive rather than reactive approach to regulation and — so as not to stifle innovation — a commitment to expedient collaboration. In effect, the regulatory environment needs to adopt its own innovative, entrepreneurial culture, and the skill sets, initiative and professional development of regulators need to rival those of their private-sector counterparts.

To achieve such a regulatory revolution, incentives must be established to make public sector work a desirable career path in its own right, not merely a stepping stone to greater economic reward in the private sector. Retention of the best and brightest should be a priority that demands the allocation of appropriate resources. Considering the trillions of dollars that remediation of our economy will absorb as a result of the current crisis, the cost of a realigning compensation structures in order to bridge this intellectual chasm amounts to little more than a rounding error.

Meanwhile, our political leadership, so adept at populist grandstanding, is plagued by an intellectual chasm between its political prowess and the knowledge, experience, and vision required to effectively govern our nation. Apparently, our most seasoned political leaders have long forgotten the “guns and butter” lessons of Economics 101 and may never have been exposed to the dynamics of the capital markets or business analysis of
an industrial enterprise. Just as many states require that professionals adhere to a program of continuing education to maintain professional licensing (e.g. Continuing Legal Education for attorneys, Continuing Professional Education for Certified Public Accountants, etc.), the public must now demand that a professional continuing education program be mandated as part of the obligations of public office. (One would hope that such a program would mandate regular refresher courses in ethics.) The pursuit of knowledge certainly would be an admirable characteristic to associate with our political leaders.

From a compensation perspective, any discussion of realigning remuneration for our political leaders would be far too controversial and is sure to be a dead end. But imagine the initiative, resourcefulness and teamwork that could be directed towards the common good if members of Congress were compensated with commissions tied to established social objectives and a balanced budget? It wouldn’t take long to bridge that intellectual chasm.

With a mandate to implement change, we must be relentless in our pursuit for new ideas. Acknowledging the intellectual chasm is essential to inspire the reform that can move America past this crisis into a new era of prosperity and influence.

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