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Leeson Loses Barings

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As 233-year-old Barings PLC went up in a puff of electrons, a market watcher of our acquaintance wondered what Nicholas William Leeson's mother must think. We figure it one of two ways: Either the 27-year-old lad who brought down Barings at a keystroke had a strict mum and saw his job as liberation from constraint; or alternatively, young Nicky is simply the youthful product of our unconstrained age. Either way, what we know now is that Nick needed watching.

As of this writing, we assume that the unaccounted for Mr. Leeson is somewhere calculating whether to turn himself over to Singaporean justice or to the Queen's back home. This, too, will no doubt tax his skills at risk-assessment; the Queen herself is a Barings client, but on the other hand 950 million whacks with a bamboo cane is no small matter.

At this early juncture in so fantastic a tale, we'll leave open the possibility that Mr. Leeson, like the Great British Train Robbers, in fact knew what he was doing. Setting that aside, though, we assume the largest lesson here has to do with risk management.

Decentralization is a key tenet of much modern management theory. One hires good people and lets them perform without a lot of intrusive and bureaucratic reporting upward. It's a good theory, and as Wall Street's annual year-end bonus stories attest, vast fortunes are now made by individuals trading for their firm's account. The firms we have spoken with in recent years assert vehemently that they have the traders' operations supervised every which way from Sunday, and the incentives would hardly suggest otherwise; after all it's *their* profit shares riding on these positions.

Still, something went awry with Joseph Jett at Kidder, Salomon Brothers' management took the fall for Paul Mozer's activities and Bankers Trust's executives must now walk the earth trying to explain why the oversight responsibility was Procter & Gamble's. Ultimately, someone in authority has to take responsibility.

So far, the derivatives business has been given a wide berth to assert that responsibility. When Washington held hearings awhile back into Bankers Trust's troubles with its clients' derivatives trades, most of the regulators testifying were remarkably supportive of both the idea of derivatives and the market's ability to supervise them. So far that judgment is holding up. While further tangles may yet emerge here, the Barings meltdown so far doesn't appear to have created system risk.

If indeed Barings' demise holds a lesson for our time, it may lie in the behavior of the Bank of England. When Barings bid to go belly up in Argentina back in 1890, the BOE bailed it out. Not this time. Tradition, old boys and all, Barings was allowed to go down, and we're attracted to the suggestion in yesterday's Journal coverage that the British authorities did so to make an object lesson of the venerable bank (losing the people who financed the Louisiana Purchase does give one pause).

Barings PLC is hardly going to be the last big name to run aground in the uncharted waters of the global economy. One could have read in these pages in recent months, for instance, of huge Western oil ventures going sour amid Russia's disorganization, of eminent investment banks getting stiffed by China, of Mexico's old political pressures flattening its new economy, of global hedge funds run by financial geniuses who bet badly and lost big for their clients.

These blowouts, however, are the exception. As sophisticated securities instruments, such as derivatives and options, supply liquidity and appropriate hedges, the system will seek the most promising investment opportunities world-wide and supply them with capital. That may mean software designers in India, garment assemblers in Malaysia, optical instrument makers in Germany or pharmaceutical researchers in New Jersey. These successes are more commonplace than the burning of a 233-year-old financial cathedral.

The system's continued success, though, will depend crucially on integrating the requirements of the modern age with the values that formerly sustained a Barings. That means market participants who support such modern business values as information transparency and internal financial controls, while preserving the bedrock of honesty and credibility.

Somehow or other, Barings PLC let a kid go off to Singapore and get lost amid the paper millions. Now Barings is gone, somebody else has their money and Nicholas William Leeson is on the lam. It's an amazing story. It could happen to anyone.

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