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Editor at Large

The Principal Issues with the Geithner Principles

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By Barbara A. Rehm

It wasn't exactly a Gary Hart moment, but it had that same confident, I-dare-you-to-test-me element to it.

Treasury Secretary Tim Geithner, just days after the Dodd-Frank Act was signed, invited the world to watch — and judge — as regulators brought the historic reform law to life.

In an Aug. 2 speech at NYU's Stern School of Business, Geithner outlined six principles that he said would guide implementation, and then he added, "You should hold us accountable for honoring them."

So nine months on, let's see how he's doing.

His first principle is speed.

"We will move as quickly as possible to bring clarity to the new rules of finance," Geithner said. "The rule-writing process traditionally has moved at a frustrating, glacial pace. We must change that."

The pace still feels glacial to many, yet key lawmakers have recently urged the Treasury Department to slow down.

For most people trying to assess how quickly the government is moving to implement Dodd-Frank the focus is on the Financial Stability Oversight Council, the 15-member group of regulators the law created to spot systemic risks and forestall another crisis.

But the council has held just four meetings in these nine months and its big task — designating which companies pose a threat to the financial system — remains a work in progress. Its two proposals have raised questions that haven't been answered. The application of many other Dodd-Frank rules, including capital surcharges, will turn on its work.

"The council's job is to first identify systemically important institutions and then decide how to deal with them," said Mark Olson, a former Federal Reserve governor and the co-chair of Treliant Risk Advisors. "But even more important, that body needs to be looking at the big picture. What systemic risks are we facing?

"I had some hope for the council, but so far its work is not encouraging."

Part of the problem is a lack of manpower. Geithner, the council's chairman, has much bigger problems, like persuading Congress not to default on the nation's debt. His department also is a victim of the slow pace of presidential appointments. The Office of Financial Research, which the law created to support the council, has no director and few employees.

"They are having trouble staffing the Financial Stability Oversight Council and the Office of Financial Research," said Matthew Richardson, director of the Salomon Center at the Stern School. "They are really having trouble getting the people in place where they can implement the rules."

Davis Polk & Wardwell LLP, which has been closely tracking Dodd-Frank's implementation, estimates that just over 5% of the 387 rules it requires have been finalized. Every one of 26 deadlines Dodd-Frank set for April was missed, according to a progress report the law firm released Monday. The next big set of deadlines will come in July with the law's first anniversary.

"Many agencies will have no choice but to miss deadlines in an increasing number of instances," the firm predicted.

Annette L. Nazareth, a Davis Polk partner and a former federal regulator herself, called the timetables imposed by the reform law "wildly aggressive."

"These agencies were dealt a very bad hand," she said. "These deadlines could actually be systemic-risk raising."

And it should be noted that some real progress has been made, including the multiagency effort on risk retention, the Federal Reserve's crackdown on proprietary trading and the Federal Deposit Insurance Corp.'s orderly-liquidation authority. Not that those rules are done either, but they are taking shape.

The Treasury secretary's second principle is "full transparency and disclosure." Geithner said regulators would draft rules and collect comments from the public. They have done so, but that's standard practice under the Administrative Procedures Act.

Geithner is probably wishing he'd skipped his third principle: simplifying and eliminating existing rules that do not work.

"We will not layer new rules on top of old, outdated ones," he said. "Everyone that is part of the financial system — the regulated and regulators — knows that we have accumulated layers of rules that can be overwhelming, and these failures of regulation were in some ways as appalling as the failures produced where regulation was absent.

"So alongside our efforts to strengthen and improve protections for the economy, we will eliminate rules that did not work. Wherever possible, we will streamline and simplify."

None of the numerous people interviewed could name a single rule that has been repealed or simplified. As one industry official put, "I'd have to give them an F-minus on that one."

Geithner's fourth principle is preserving financial innovation.

"Our system allowed too much freedom for predation, abuse and excess risk, but as we put in place rules to correct for those mistakes, we have to strive to achieve a careful balance and safeguard the freedom, competition and innovation that are essential for growth."

By definition the law is likely to inhibit financial innovation, at least in the short term, because companies are focusing so much energy on compliance and raising capital. In fact, some sources joked that the only innovation going on in financial services right now is finding ways to duck the Durbin interchange amendment.

"We certainly haven't seen any innovation," said Wayne Abernathy, executive vice president of financial institutions policy and regulatory affairs at the American Bankers Association. "I think that's a result of people don't know what the attitude of the regulators will be so nobody is willing to try anything new."

Ensuring a more level playing field among financial companies and economies around the world is Geithner's fifth principle. "We will do this by setting high global standards and blocking a 'race to the bottom' from taking place outside the United States," he said.

Stopping a race to the bottom would be a neat trick, but regardless international cooperation peaked many months ago. Most countries, including ours, are pursuing their own reform agendas. Many in the industry, and some on Capitol Hill, worry that too-stiff rules here will put U.S. firms at a competitive disadvantage.

"The rhetoric is great, but the reality is we are going it alone, moving unilaterally first," said Greg Wilson, author of "Managing to the New Regulatory Reality: Doing Business Under the Dodd-Frank Act." "If the rest of the world doesn't catch up … that will be a negative for our institutions and markets."

Geithner's final principle is perhaps the toughest one: bring more order and integration to the regulatory process. He said the agencies responsible for reforms will have to work "together, not against each other.

"This requires us to look carefully at the overall interaction of regulations designed by different regulators and assess the overall burden they present relative to the benefits they offer."

In the end, this principle trumps all the others. But so far regulators are having trouble reaching consensus, even on relatively minor issues like the definition of a block trade or how municipal advisers should be registered.

Like Olson, Wilson pegged the oversight council as the one entity that could ensure Dodd-Frank implementation makes sense.

"Is the council really stepping back to think through priorities, economic impact, the sequencing of these rules," he asked. "How does Basel III fit with resolution planning, and how does that fit with early remediation? I don't think anybody is thinking at that level to bring more order and integration."

Treasury Deputy Secretary Neal Wolin defended the government's progress in a recent speech, arguing regulators are "implementing the statute in a careful, considered and serious manner."

Wolin acknowledged the authority of independent regulatory agencies but said they are "working through differences" to get "the substance right."

The oversight council, he said, can claim credit for developing an integrated road map, coordinating the risk-retention proposal and developing a consensus behind the Volcker Rule.

Today, Geithner may wish he had set less-ambitious goals.

"It was brave at the time; in retrospect it was pure chutzpah," Olson said. "If you look at the six principles, there is only one that could be given a really good grade, and that's transparency."

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