Geithner's Hollow 'Speed' Pledge to Business

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Businesses must know the rules of the game before risking their capital. And so, in his speech at New York University's Stern School of Business on Aug. 2, Treasury Secretary Tim Geithner assured his audience that the massive regulatory reforms of the new Dodd-Frank legislation would be implemented quickly to remove the drag of uncertainty on the economy. "First we have an obligation of speed," he said, and asked to be held accountable if his pledge was not honored.

We might as well hold him accountable now, because his promise is impossible to fulfill. His plea to business—"Don't wait for Washington to draft every rule before you start changing how you do business"—will and should fall on deaf ears. There are four main reasons Mr. Geithner's pledge is hollow.

First, Dodd-Frank failed to consolidate and rationalize the regulatory structure. Indeed, the new law makes matters worse by creating new regulators, an unwieldy Financial Stability Oversight Council (10 members who act on a two-thirds vote), the Consumer Financial Protection Bureau, and the Office of National Insurance. But an increasingly balkanized regulatory structure means separate timetables and priorities and jurisdictional clashes among the separate agencies—more uncertainty.

Second, Mr. Geithner's pledge ignores the basic legal requirement for deliberative and rational regulatory implementation. He argued that the "frustrating, glacial pace" of rule writing must change, all the while promising that the regulatory agencies will consult broadly and draft rules that will be published and available for comment.

The Administrative Procedure Act requires notice and comment on new rules, and, importantly, that these rules have a rational basis. The courts have interpreted this requirement to include a cost-benefit test. For example, in *Chamber of Commerce v. SEC*, the D.C. Circuit Court of Appeals twice struck down, in 2005 and 2006, an SEC rule requiring mutual funds to have boards comprised of at least 75% independent directors and an independent chairman. The court ruled that the agency failed to adequately analyze its costs and benefits. Dodd-Frank specifically calls for an economic cost determination for any recommendations to regulators made by the Financial Stability Oversight Council. So the reality is formulating new rules will take a long time.

Third, uncertainty springs from the new law itself, through the creation of the Consumer Financial Protection Bureau, an agency with a budget of roughly $500 million per year that has yet to be created. This agency has broad jurisdiction over the entire financial system—it could ban products or cap fees. Michael Barr, the Treasury department's assistant secretary for financial institutions and a leading candidate to head the new agency, has advocated having only "plain vanilla" products without specifiying what these might be; further uncertainty.

Mr. Geithner opined that when the new Financial Stability Oversight Council first meets in September (a month from now) it "will establish an integrated road map for the first stages of reform." This road map will not, however, include the plans of the consumer bureau.

Fourth, Mr. Geithner's "obligation of speed" ignores the international process for setting capital requirements for financial institutions. These requirements have a major impact on the activities in which financial institutions engage. They operate like a tax, and if they reduce the profitability of a financial product or service, then institutions will gravitate to other businesses.

Without knowing what such "taxes" will be, businesses are naturally reluctant to invest. But capital requirements are not set by the Treasury; they are instead effectively set by the Basel Committee on Banking Supervision, a group of regulators from 27 countries. While the United States participates in the group, it does not control its actions.

Over the past 22 years, this group has promulgated two generations of capital requirements, Basel I and II, which performed badly during the crisis. Indeed, U.S. banking regulators have yet to implement Basel II, the delay springing from concern about its design and impact. The committee is now at work on Basel III capital requirements, together with new liquidity rules. Formulation of these rules is still in progress and their implementation is years away. Many financial specialists question whether the process will deliver an efficient and effective set of rules and requirements.

Despite the Geithner pledge to "move as quickly as possible to bring clarity to the new rules of finance," the implementation of Dodd-Frank will take considerable time and leave a pall of uncertainty hanging over business decisions. The vagueness of the statute, necessitating gap-filling regulation, is the result of the desire in Congress to enact massive reforms quickly and its need to put together a fragile majority to do so. It would have been easier if the administration had advocated, and the Congress had designed, a more efficient regulatory structure to implement its reforms. Having narrowed the options to the slow lane, Mr. Geithner now urges the fast lane.

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