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Time for Tim to act tough

Geithner's proposal to give regulators moreauthority to seize troubled financials may not go far enough. Why is nobody threatening to shake up management?

By Paul R. La Monica,

NEW YORK (CNNMoney.com) -- Treasury Secretary Tim Geithner proposed tough new rules Tuesday, saying they could prevent another AIG debacle.

Still, I'm torn as to whether the Treasury should be given broad powers to "resolve" issues at non-banks such as AIG (AIG, Fortune 500). There is serious concern about giving Treasury too much responsibility.

"This is an unprecedented grab of power and before that occurs there ought to be a real debate about whether we should give that authority to the Treasury Secretary," said House Minority Leader John Boehner, R-Ohio, Tuesday morning.

In addition, it's tough to set hard standards for what, exactly, an insurer or bank should do and shouldn't do. The entire point of banking is to make loans in the hopes of being paid back. So if a bank wants to take a major gamble, it should be allowed to do so. And if it collapses because of that decision, it should be allowed to fail.

"Financials are in the risk-taking business, so where do you draw the line between appropriate risks and non-appropriate risks? It's hard to legislate behavior," said Chip MacDonald, a partner with the capital markets group at law firm Jones Day in Atlanta.

What's more, there is a strong case to be made that the government has meddled too much already -- with little to show for it. Giving the government more power to seize and break up failing firms may accomplish nothing more than satisfying the public's bloodlust for all things Wall Street.

"I recognize there is a populist sentiment to punish people. But I don't think anyone could make a case why more government intervention will solve any of our problems," said Rich Hughes, co-president of Portfolio Management Consultants, an investment firm with $7 billion in assets under management.

But the government has already stepped in. So it would be nice if someone had the power to do with insurers - and other financial firms that aren't bank holding companies - what the FDIC does with troubled banks: seize them and sell them off to healthier banks.

In that regard, Geithner's proposal may not go far enough. If the Treasury wants to be able to take over companies in peril, shouldn't regulators also be willing to dump management teams that put the company in harm's way?

In Geithner's testimony to the House Financial Committee on Tuesday, he gave a laundry list of the powers he'd like Treasury to have. Among them, he said the government should be allowed to "provide financial assistance to make loans to an institution, purchase its obligations or assets, assume or guarantee its liabilities, and purchase an equity interest."

But he made no mention of the possible need to replace CEOs and other executives. It wasn't mentioned by Federal Reserve chairman Ben Bernanke, who endorsed Geithner's plan, in his prepared remarks either.

Maybe it's implicit that if Treasury uses the power it is seeking, it will actually throw out the bums who are responsible for the mess. And to be fair, when the government first announced its $85 billion loan to AIG in September, Robert Willumstad, AIG's CEO at the time, immediately stepped down.

But Willumstad was only on the job for three months to begin with. So getting rid of him was hardly an example of forcing out a guy who was responsible for the years of bad behavior that led up to AIG's implosion.

Explicitly stating the need to shake up the corner office could have gone a long way toward restoring some of the public confidence and trust in the government and banking sector. That faith has evaporated in the past few months as one bailout after another takes place, and, for the most part, the names of the CEOs getting the money remains the same.

There has been such a myopic focus on how excessive the executive compensation is that a bigger issue is not being addressed: Is it time for new blood to come in and address the banking sector's woes?

"Just changing the amount of regulatory power isn't going to get it done. The need to replace executives is a crucial aspect that has been lost on regulators during this crisis," said Joseph R. Mason, chaired professor of banking at Louisiana State University.

Mason pointed to the example of the Royal Bank of Scotland (RBS), which received a bailout from the British government. When the bank was taken over last fall, CEO Fred Goodwin was ousted and new CEO Stephen Hester immediately started to scale back the company's operations after years of acquisitions by Goodwin.

"Look at the RBS bailout. One of the positives was that the top management was changed and there has been a willingness to sell assets and make changes," Mason said. "That's what should happens in a resolution. You resolve the problems that caused the mess in the first place."

Washington has already committed more than a trillion dollars to various financial bailouts. But all that's happened to the senior managers is that lawmakers drag them in front of Congress for public floggings or verbally slap them on the wrists about bonuses, buying corporate jets or sponsoring golf tournaments and

Now don't get me wrong. I'm not suggesting that the government completely clean house at every bank it's invested in. After all, the problem with all the haranguing over the AIG bonuses is that it is a witch hunt.
"Going in and throwing all the bastards out is not a policy. It's pitchforks and torches," said Daniel Alpert, managing director with Westwood Capital, an investment bank in New York.

Still, it might not be a bad idea for regulators to not so subtly remind financials that once they do purchase a stake in them, they have a very important say in how business should be run going forward.

And the best way to do that is to put executives at companies receiving taxpayer funding on notice and tell them in no uncertain terms that their job is not an entitlement.

"What needs to happen is that when the government becomes a large shareholder, it does need to consider whether management is making the right decisions. If not, then sure you should get rid of them," Alpert said.