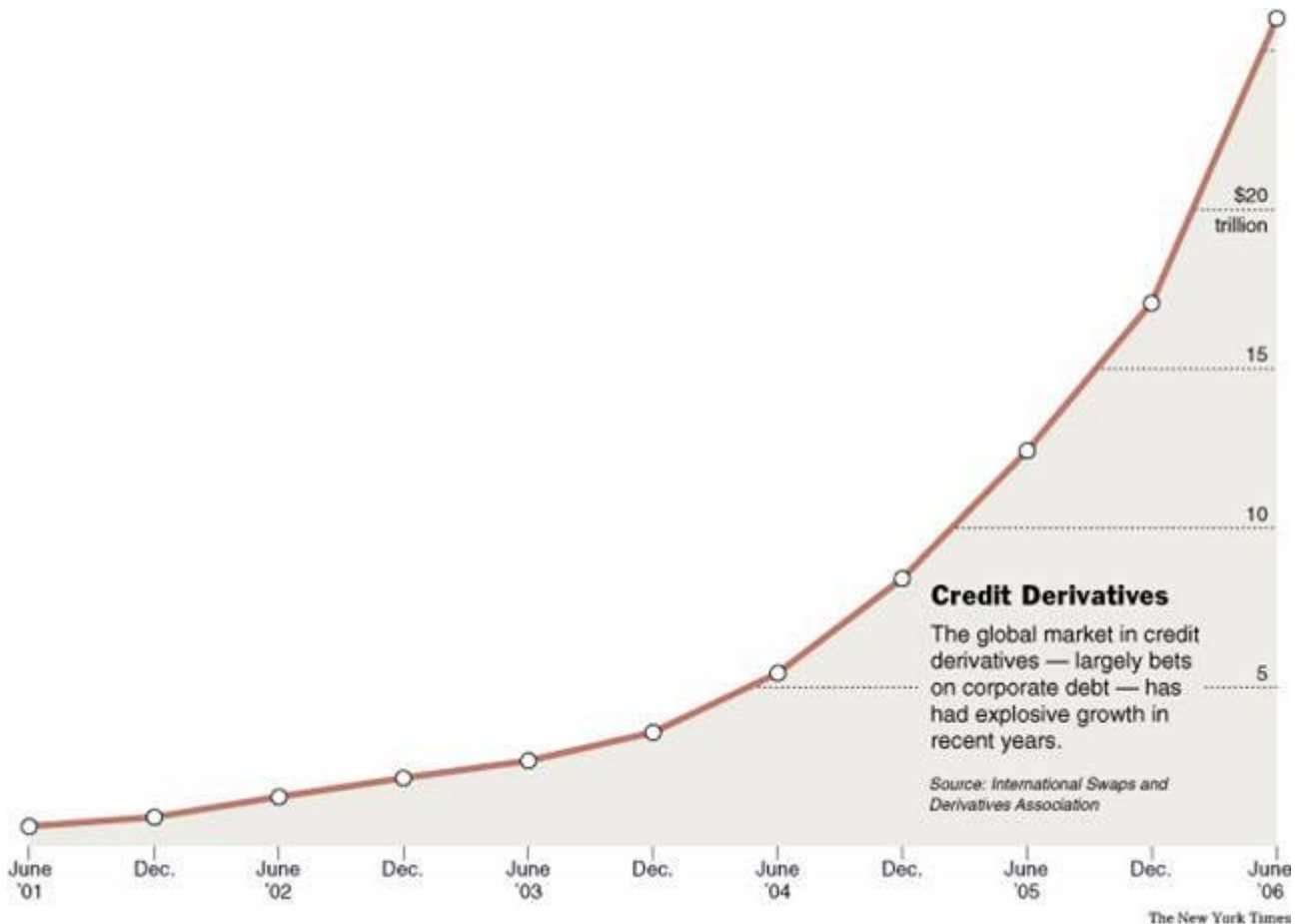


Timothy F. Geithner is 45, but he looks considerably younger, with an easy smile and hardly a wrinkle in sight.



E. Gerald Corrigan, a former chief of the New York Federal Reserve, suggested that Timothy Geithner study the Long-Term Capital crisis.

“I think by nature Tim does not get stressed out,” said [Robert E. Rubin](#), the former Treasury secretary who was one of his bosses before Mr. Geithner took the helm of the [Federal Reserve Bank of New York](#) in 2003. “He has a calm way in the face of whatever he’s facing and an irreverent sense of humor.”

He may need all the equanimity he can muster.

High on Mr. Geithner’s to-do list is understanding and monitoring the \$26 trillion credit derivatives market — twice the size of the United States economy — the fastest-growing financial market there is. Its explosive growth has greased the wheels of the global economy, increasing liquidity, spreading risk and minting money for Wall Street along the way. But it has surged at a time when volatility has been low, debt has been historically cheap and defaults have been virtually absent. When this market gets tested, no one knows for certain how it may react.

Even the heads of some of the world's biggest banks seem overwhelmed by the size and complexity of credit derivatives. "It makes my head swim," said Kenneth D. Lewis, the chief executive of [Bank of America](#).

If the brave new world of finance is daunting, the man in charge of it is not. With a boyish charm and a dry sense of humor, Mr. Geithner has taken advantage of the current calm waters of the financial markets to take an active stance, rallying Wall Street to peel apart the market of credit derivatives to try to understand its potential risks. As a financial regulator, his style is more like a cerebral Dr. Phil than an [Eliot Spitzer](#), the former attorney general and now governor of New York, who reveled in showdowns with Wall Street.

Mr. Geithner is the anti-Eliot.

Of course, Federal Reserve bank chiefs are typically less confrontational, charged with stability, as well as being a critical part of setting monetary policy. But he has been unusually productive in tackling issues widely viewed as uncomfortably complex.

"Tim loves projects, and he wraps his projects in packages that everyone wants to be part of," said Annette L. Nazareth, a Securities and Exchange commissioner who has known Mr. Geithner since he worked at the Treasury Department.

As Mr. Rubin put it: "He's elbow-less. It's really remarkable."

That has been amply illustrated in how he has persuaded Wall Street to take ownership of the issues surrounding credit derivatives: from the plumbing that makes the system function to more aggressive and creative stress-testing to the relationship between hedge funds and banks. His approach has aimed at helping them believe that they are masters of their own destiny rather than miscreants who need to be punished, while extracting improvements in the financial system along the way.

"Tim manages to get people to work together to reach a higher place," said Thomas A. Russo, chief legal officer at [Lehman Brothers](#). "He has essentially put the plumbing of the business on equal footing with the revenue side, which is an enormous accomplishment."

If ever a market required creative thinking, the credit derivative market is it.

"We've seen substantial change in the financial system, with the emergence of a very large universe of leveraged private funds, rapid growth in exposures to more complicated and less liquid financial instruments, all during a period of very low volatility," said Mr. Geithner in an interview in his elegant office in Lower Manhattan. "This means we know less about market dynamics in conditions of stress."

A credit derivative is a contract by two parties that allows a participant to reduce its exposure to the risk of default on bonds, loans, government securities or corporate securities. The cornerstone of the credit derivatives market is credit default swaps, a sort of insurance policy that allows two parties to exchange the credit risk of an issuer. Originally introduced as an instrument to bet on defaults, it has evolved into a widely used trading tool, especially among hedge funds, to bet on interest rates and spreads.

Credit derivatives are intended to reduce risk by spreading it out to as many parties as possible. That is generally considered desirable. Yet the size of the market, the lack of a history with such investments during financial stress and the worry that the clearing mechanism — the plumbing of the system — will function when the markets hit the skids are red flags for people in the business who know how quickly the spigot can turn off.

“The fact that the banks are stronger and risk is spread more broadly should make the system more stable,” Mr. Geithner said. “We can’t know that with certainty though. We’ll have a test of that when things next threaten to fall apart.”

Regulators struggle to imagine what the shock could be, but do know that the reaction will be far different from crises of the past. When Long-Term Capital Management tottered on the brink of collapse in 1998, the credit markets in the United States were controlled by such a small number of institutions that the New York Fed had to make calls to 14 Wall Street banks to try to resolve the crisis. Today, the number of institutions would be vastly higher.

Nevertheless, at the center of the universe of credit derivatives are still a handful of institutions that create, trade and manage much of the risk of these products and that also manage the risk of trading by lending to hedge funds. Mr. Geithner’s job, when he is not working on monetary policy, is to make sure they are prudently managing that risk.

He has some background in financial crises. He joined the Treasury Department in 1988 and was noticed by [Lawrence Summers](#), then the Treasury secretary. He was the only career civil servant to become an under secretary of Treasury (for international affairs).

Mr. Geithner uses wry humor to balance a natural wonkishness. At a recent breakfast at the [Council on Foreign Relations](#), he was asked if he could comment on the Chinese currency’s potential impact on the trade deficit. “Just to be crisp, no,” he responded with a sly smile. The room filled with laughter. He added that he had spent his youth preparing cards for incoming Treasury secretaries that instructed them in no uncertain terms to avoid answering any question related to the exchange rate.

At the same time, his intellect is apparent, captured in paragraph-long responses. During the same breakfast meeting, when someone asked about the factors that could affect the status of the dollar as a reserve currency, an animated Mr. Geithner responded “great question,” and then started his answer by recalling an academic paper he had read 15 years ago on the topic, citing its thesis, explaining its logic and remembering the last line as one might remember a line from “Gone With the Wind.”

“He does this Columbo thing,” Ms. Nazareth said. “He looks like he’s distracted and not listening, and then he’ll say, ‘Well, I don’t know much about this’ and then he starts talking and five paragraphs later you realize there is a logical string that connects all of it. And then you realize this kid who doesn’t know anything just outdid everyone.”

When Mr. Geithner arrived at the New York Fed, E. Gerald Corrigan, a former Federal Reserve president himself, suggested that he look at the conclusions of the Counterparty Risk Management Group Report, the report compiled after Long-Term Capital. Mr. Corrigan thought it might be useful to look at those risks in the context of the rise of private money and the rapidly transforming credit markets.

In 2004, Mr. Geithner’s staff conducted an extensive review of counterparty risk. But rather than dump its conclusions on the industry, he chose to stay behind the scenes while encouraging Mr. Corrigan to reconvene the group. In January 2005, Mr. Corrigan brought together a group that included some of the most senior executives on Wall Street. Six months later, the group produced a report that made 47 recommendations on issues from the very technical to the philosophical.

Central to the report’s findings were shocking weaknesses in the way credit derivatives were being assigned and traded around without any sense of who owned what. The so-called “assignment issue” was simple: credit derivatives were negotiated by two parties, say JPMorgan and [Goldman Sachs](#). But banks were “assigning” the contracts out to others — like hedge funds — without telling each other. It was a little bit like lending money to a friend who is really rich who in turn lends it to her

deadbeat brother and fails to mention it.

“It violated the first and most sacred principle of banking: know your counterparty,” Mr. Corrigan said.

In September 2005, Mr. Geithner brought together the so-called 14 families of Wall Street and told them to fix the problems they had found. They set goals. Then he raised them. “You want to have a tipping-point dynamic, where the targets were ambitious enough that they would be forced to put a lot of resources to work, all together, quickly, otherwise you might not get traction,” he said.

Standards were set, and backlogs came down sharply. One particularly effective tactic was to collect data from everyone and anonymously distribute it to the group so that every bank — and that bank’s regulator — could see how it measured up.

The industry felt triumphant about being part of the solution. It was a classic “collective action” problem solved: the industry had set an abysmally low standard and no one would budge for fear of losing business, so someone had to move everyone.

Improving the processing of credit derivatives was only the first step. Soon after, he initiated a comprehensive examination of stress-testing, looking at how banks measure and test exposure to certain market players and market risks in different kinds of conditions, like the failure of one major firm. Working closely with European regulators, he is looking at the relationship between banks and hedge funds.

The real test, of course, will be when a crisis hits, whatever the crisis may be.

He is currently reading a book about uncertainty in the medical profession. It’s a familiar topic. When Mr. Rubin retired from the Treasury, Mr. Geithner provided him a list entitled “The Rubin Doctrine of International Finance.” The No. 1 principle? “The only certainty in life is that nothing is certain.”