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Stop Treating Wall Streeters Like Villains and Resolve This Crisis

By Bob McTeer

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UPDATE: Bob McTeer, former president of the Federal Reserve Bank of Dallas and a distinguished fellow at the National Center for Policy Analysis, responds to some of your comments here.

Maybe it's a good thing the "consensus" rescue plan failed on Monday. That gives Congress a chance to pass a plan that helps resolve the current crisis rather than just demonizing Wall Street.

The numerous add-ons to the Treasury bailout plan to protect the taxpayer were not only unnecessary, but actually harmful because they were punitive in nature and made participation in the program less attractive for holders of illiquid assets. In fact, all the focus on C.E.O. salary caps, golden parachutes, warrants and so forth, implied that the holders of illiquid mortgage-backed securities were the villains in this drama rather than victims. They didn't package the securities, or sell them; they bought them as an investment. I'm sure negative Congressional rhetoric on these punitive taxpayer protections contributed to the feeling in the public that money was being given to the undeserving.

While I don't claim that it played a decisive role, the government had encouraged the purchase of mortgage-backed securities by giving banks C.R.A. (Community Reinvestment Act) credit for securities that contained mortgages made in certain ZIP codes. Those that complied with Congressional wishes in that regard are now being threatened by the same Congress. Plus, all the speechifying about Main Street bailing out Wall Street, and about teaching Wall Street a lesson, surely contributed to the widespread misunderstanding of the purpose behind the rescue package, a misunderstanding that was the ultimate cause of its defeat.

Every "ordinary American" I talked to about the plan, including family and neighbors, misunderstood the plan and hated it. They viewed it as using their tax dollars to bail out rich corrupt Wall Street types. Despite repetition over and over on TV and in the press that the bailout did not involve ordinary government expenditures but involved a purchase of assets that would be resold, most likely at a profit, that message never sank in. The legislators faced almost unanimous negative feedback from their constituents. We needed some profiles in courage. We probably had some, but not enough.

For months, I've advocated a simple measure that would make a big difference — the suspension or alteration of mark-to-market accounting rules. My latest effort was an article in Forbes.com reproduced on my blog.

The Securities and Exchange Commission's authority to suspend mark-to-market accounting was reaffirmed in the draft legislation, but apparently only after a study by the Government Accountability Office. No further study is needed.

Simply put, mark-to-market accounting means banks have to value their assets according to what they're worth on the open market. Right now many troubled assets like mortgage-backed securities aren't trading, though, which means they're being valued at unrealistically low levels. This in turn means banks are marking down their asset values, and thus their capital, resulting not only from actual losses, but from lower values of securities not trading — even though those same banks may have the capacity to hold those securities to maturity. Mark-to-market was never intended for use in a declining market. I have no standing in this area, but suspension has also been advocated strongly by William Isaac, former chairman of the Federal Deposit Insurance Corporation, who is very experienced in this area.

(Late Tuesday, the S.E.C. announced that further study of the mark-to-market issue would take place in the days to come. In the meantime, in a Q&A format, it clarified the application of the existing rule under present conditions when little or no trading is taking place. The intention was to provide the clarification in time for the preparation of third-quarter reports. The clarification was applauded by the American Bankers Association as helpful flexibility in the application of the rules. Hopefully, a further, more formal liberalization will be forthcoming soon, and, perhaps, be included in an improved "bailout" bill. My expectation is that relaxation of mark-to-market rules will turn out to be the most helpful provision of the whole package.)

Mr. Isaac has also been pushing "net-worth certificates" similar to the ones he used during the savings and loan crisis in the 1980s as another major approach that doesn't require the government to put up up-front money. The idea is that the F.D.I.C. gives banks it feels have a good chance of recovering a certificate that can count temporarily as capital in exchange for a note from the bank. Call it synthetic capital. I think both these ideas should be considered because of their zero up-front price tag.

I don't have any idea how this will be resolved, but we need a fast fix before our 401(k)'s evaporate completely — well, mine anyway. I need some relief. The decline in the stock market on Monday gave us a taste of how the markets feel about inaction. As of Tuesday afternoon it looked as if there might finally be some movement on the issue.

Needing relief reminds me of a story from the country comedian Jerry Clower several years ago. Two hunters were hunting for raccoons at night. One thought he had one treed and went up into the tree after him, but it turned out to be a wildcat. He and the wildcat went round and round. Blood and fur flew, and the hunter begged his friend to "shoot this thing, shoot this thing!" The friend said, “I can’t shoot; I might hit you.” Our hunter’s response was, “Well, shoot up in here amongst us; one of us needs some relief.”

Precisely.