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Congress Helped Banks Defang Key Rule

By SUSAN PULLIAM and TOM MCGINTY

Not long after the bottom fell out of the market for mortgage securities last fall, a group of financial firms took aim at an accounting rule that forced them to report billions of dollars of losses on those assets.

Marshalling a multimillion-dollar lobbying campaign, these firms persuaded key members of Congress to pressure the accounting industry to change the rule in April. The payoff is likely to be fatter bottom lines in the second quarter.

The accounting issue lies at the heart of the financial crisis: Are the hardest-to-value securities worth no more than what the market is willing to pay, or did the market grow too dysfunctional to properly set values?

The rule change angered some investor advocates. "This is political interference on a major issue, and it raises questions about whether accounting standards going forward will have the quality and integrity that the market needs," says Patrick Finnegan, director of financial-reporting policy for CFA Institute Centre for Financial Market Integrity, an investor trade group.

Backers of the change say it was necessary because existing accounting rules never contemplated the kind of market turmoil that unfolded last year.

The rules had required banks, securities firms and insurers to use market prices to help assign values to mortgage securities and other assets that don't trade on exchanges -- to "mark to market." But when markets went haywire last fall, financial firms complained that the rules forced them to slash the value of many assets based on fire-sale prices. That contributed to big losses that depleted their capital and left several of the nation's largest firms on the brink of failure.

Earlier this year, financial-services organizations put their lobbyists on the case. Thirty-one financial firms and trade groups formed a coalition and spent \$27.6 million in the first quarter lobbying Washington about the rule and other issues, according to a Wall Street Journal analysis of public filings. They also directed campaign contributions totaling \$286,000 to legislators on a key committee, many of whom pushed for the rule change, the filings indicate.

Rep. Paul Kanjorski, a Pennsylvania Democrat who heads the House Financial Services subcommittee that pressed for the accounting change, received \$18,500 from coalition members in the first quarter, the second-highest total among committee members, according to Federal Election Commission records. Over the past two years, Mr. Kanjorski received \$704,000 in contributions from banking and insurance firms, the third-highest total among members of Congress, according to the FEC and the Center for Responsive Politics.

A spokeswoman says Rep. Kanjorski believes the accounting industry's rule-making body, the Financial Accounting Standards Board, or FASB, made the right move since neither mark-to-market critics nor advocates are "entirely pleased with the outcome." She says campaign contributions didn't factor into the congressman's thinking.

Congressional Attention

During a March 12 hearing before the House subcommittee, FASB came under intense pressure from committee members. "If the regulators and standard setters do not act now to improve the standards, then the Congress will have no other option than to act itself," Rep. Kanjorski said in his opening remarks.

"We want you to act," Rep. Kanjorski told Robert Herz, FASB's chief. Mr. Herz waffled about how quickly the standards board could act. Rep. Kanjorski leaned over the dais. "You do understand the message that we're sending?" he said.

"Yes," Mr. Herz replied. "I absolutely do, sir."

FASB made speedy revisions to its rules. In an interview, Mr. Herz said FASB merely accelerated the matter on its agenda, and tried to be responsive to input from investors and financial-services firms.

The change helped turn around investor sentiment on banks. Financial firms had the option of reflecting the accounting change in their first-quarter results; they will be required to do so in the second quarter. Wells Fargo & Co. said the change increased its capital by \$4.4 billion in the first quarter. Citigroup Inc. said the change added \$413 million to first-quarter earnings. The Federal Home Loan Bank of Boston said the shift boosted its first-quarter earnings by \$349 million.

Robert Willens, a tax and accounting analyst, estimates that the changes will increase bank earnings in the second quarter by an average of 7%.

Building Pressure

The American Bankers Association, a trade group, acknowledges that it exerted pressure to change the rules. The ABA was the biggest donor to the campaign funds of committee members in the weeks before the hearing. It gave a total of \$74,500 to 33 members of the committee in the first quarter, according to the Journal analysis of public filings. An ABA spokesman says that is its normal level of support for lawmakers, and that the initiative was part of a broader effort to change accounting rules.

"We worked that hearing," says ABA President Edward Yingling. "We told people that the hearing should be used to talk about the big problems with 'mark to market,' and you had 20 straight members of Congress, one after another, turn to FASB and say, 'Fix it.'"

The banking industry's victory stands in contrast to at least one defeat it has been dealt in recent weeks, on new credit-card legislation.

Changing Environment

Mark-to-market accounting has been around for decades. Many banks were content with the rules when the markets were going up. But the rules became a big problem in late 2007. As markets turned down, FASB clarified the rules and established how certain financial instruments, including mortgage securities, should be valued.

The guidelines said valuations should reflect "observable" input such as market prices whenever possible. They required banks to disclose extensive information about assets they were unable to value based on market prices.

Financial firms last year reported losses or write-downs totaling roughly \$175 billion, according to Michael Mayo, an analyst at the CLSA unit of Credit Agricole SA.

The lobbying plan began taking shape last year. Stock and bond markets were tanking. Lehman Brothers Holdings Inc. collapsed in September. Some markets seized up, including those for mortgage securities. Investors worried that some banks and other financial firms might not survive if they didn't begin posting profits in 2009.

Conrad Hewitt, then the Securities and Exchange Commission's chief accountant, says financial-services representatives, including the ABA's, called his office repeatedly. He says he met with executives of Citigroup and Wells Fargo, among others.

Last year, Mr. Hewitt recalls, he challenged ABA lobbyist Donna Fisher and a Wells Fargo executive on their valuation complaints. "If you say you're required to value the securities at 50 cents," he recalls asking, "and you believe that the securities are really worth 80 or 90 cents, do you have a lot of buyers because of this unusually low valuation?"

The two responded that there were no buyers, according to Mr. Hewitt.

"Then maybe the securities should be valued at *less* than 50 cents," Mr. Hewitt says he responded.

Ms. Fisher declined to comment, as did Wells Fargo. Mr. Hewitt now is a consultant to financial firms.

The lobbying picked up early this year. Lawmakers were growing more concerned about the problems spreading. Federal regulators were forced to guarantee billions of dollars in uninsured deposits at credit unions, which are member-owned cooperative banks. The Federal Home Loan Banks -- cooperatives owned by more than 8,000 commercial banks, thrifts, credit unions and insurers -- took billions of dollars in write-downs on their mortgage securities.

Mr. Yingling, the ABA president, says his organization assigned at least four of its roughly dozen Washington lobbyists to meet with members of the House Financial Services Committee.

"Their instructions for the early part of this year were to talk to as many people about 'mark to market' as they can," he says.

In late January, Mr. Yingling says, he met with Rep. Ed Perlmutter, a Colorado Democrat. Mr. Perlmutter said he was "very concerned" about the mark-to-market accounting issue.

The ABA sent campaign contributions, ranging from \$500 to \$5,000, to the 33 committee members. The ABA's political action committee, Mr. Yingling notes, was focusing on dozens of issues in addition to mark-to-market accounting.

Rep. Perlmutter received \$2,500 from the ABA, according to public filings. He says he believed the accounting rules were causing "a drastic loss in capital that never should have occurred." He says the ABA money "had no influence" on his thinking.

Rep. Frank Lucas, an Oklahoma Republican, also received \$2,500 from the ABA, the filings indicate. He says the contributions didn't sway his thinking and that the rules were making it difficult for even healthy banks to weather the downturn.

On Feb. 18, FASB said it didn't expect to complete its examination of mark-to-market standards until the end of June.

Banks, credit unions, Federal Home Loan Banks and insurance company trade associations launched in late February what they called the "Fair Value Coalition." Its goal was to change the accounting rules. The coalition itself raised no funds, leaving it to its members to make political contributions.

On March 5, Reps. Perlmutter and Lucas introduced legislation to broaden oversight of FASB, putting it under the purview of not only the SEC, but also the Federal Reserve Board, Treasury Department, Federal Deposit Insurance

Corp. and the Public Company Accounting Oversight Board.

Four days later, the Fair Value Coalition wrote to Rep. Barney Frank, the Massachusetts Democrat who heads the House Financial Services Committee, and to Rep. Spencer Bachus, an Alabama Republican who was an early advocate of changing the rules. The letter, signed by 31 institutions and trade groups, called on Congress to use the hearings to address the "unacceptable" pace of FASB and to "correct the unintended consequences" of mark-to-market accounting.

In an interview, Rep. Frank, who got \$8,500 from coalition members in late March, said a "wide range of people concerned about the economy, not just banks, were pushing for this."

Rep. Kanjorski scheduled a hearing on the issue for March 12. Bank lobbyists jammed a congressional hearing room. In his opening remarks, Rep. Kanjorski threatened that Congress would get involved if FASB didn't act. Rep. Perlmutter said mark-to-market accounting was "exaggerating and multiplying" the economic slump. "We have been dithering while this patient's been sick," he said.

Speedier Timetable

Rep. Gary Ackerman (D., N.Y.) and Rep. Kanjorski pushed Mr. Herz to agree to a speedier timetable. They repeatedly cited Rep. Perlmutter's legislation to broaden oversight of FASB.

"It will be done in three weeks. Can and will," Rep. Ackerman instructed Mr. Herz.

"Yes," Mr. Herz replied.

"Can and will," Rep. Ackerman repeated. Rep. Ackerman declined to comment through a spokesman.

A FASB director, Lawrence Smith, said at the time that FASB had little choice but to act. "We can't ignore what's going on around us," he said.

On April 2, FASB introduced the changes that lawmakers sought. In a draft proposal, FASB changed its rules to say that financial firms could "presume" markets were dysfunctional unless there was ample evidence otherwise. Then they could use internal models to set values, rather than market prices. Their models are not fully disclosed to investors.

But many investor groups opposed the changes. In the final proposal, FASB deleted the word "presume." It was a modest setback for the industry: Financial firms couldn't use internal pricing models to value assets unless a series of conditions existed indicating that markets were dysfunctional.

Backlash at FASB

Still, many saw the new rules as a watering down of standards. That triggered a backlash within FASB. At a meeting of a FASB advisory group in New York on April 28, three of its members threatened to resign in protest, concerned that FASB had jeopardized its credibility.

Lynn Turner, the SEC's former chief accountant and a former FASB member, was one of them. He says he doesn't think the banking industry will be satisfied until mark-to-market accounting is dismantled completely. "Despite efforts by FASB to give ground to the banks, enough is never enough," he says.

Now, the Fair Value Coalition is gearing up to take on mark-to-market accounting again.

On April 27, a member of the House subcommittee sent a letter to Rep. Frank calling for another hearing to revisit the issue. A FASB spokesman says the group is continuing to look at the issue.

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