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Commentary

Suspend Mark-To-Market Now!

Newt Gingrich, 09.29.08, 06:05 PM EDT

The one regulatory action that will calm our markets.



On Monday, Congress voted against passing the bailout package for Wall Street. The stock market reacted immediately, falling almost 800 points. It is clear that something needs to be done, and in the coming days, a new package must be constructed that has the support of the American people that both deals with the

[liquidity crisis](#) and sets the stage for long-term economic growth.

However, there is an immediate step that could be taken right now that would calm the markets and dramatically reduce taxpayer risk in any future government intervention.

Today the Treasury secretary released the following statement:

"I and my colleagues at the Fed and the SEC continue to address the market challenges we are facing on a daily basis. I am committed to continuing to work with my fellow regulators to use all the tools available to protect our financial system and our economy."

While Congress and the White House consider next steps, the Treasury and its fellow regulators should follow their own counsel and take without delay the one regulatory action within their discretion that can help immediately to calm markets and dramatically reduce the taxpayer risk in any necessary government intervention: suspend mark-to-market.

Chief economist [Brian S. Wesbury and his colleague Bob Stein](#) at First Trust Portfolios of Chicago [estimate](#) the impact of the "mark-to-market" accounting rule on the current crisis as follows:

"It is true that the root of this crisis is bad [mortgage loans](#), but *probably 70% of the real crisis that we face today is caused by mark-to-market accounting in an illiquid market.* What's most fascinating is that the Treasury is selling its plan as a way to put a bottom in mortgage pool prices, tipping its hat to the problem of mark-to-market accounting without acknowledging it. It is a real shame that there is so little discussion of this reality." (Emphasis added.)

If regulators on their own--or Congress, if regulators fail to use their discretion--can fix 70% of the financial crisis by changing the mark-to-market accounting rule, we should change the rule first before attempting to pass another reevaluated bailout package.

"Mark-to-Market" Accounting and the Origins of the

Financial Crisis: Mark-to-market accounting (also known as

"fair value" accounting) means that companies must value the assets on their balance sheets based on the latest market indicators of the price that those assets could be sold for immediately. Under such a rule, declining housing prices don't just reduce the value of defaulting mortgages. They reduce the value of all mortgages and all mortgage-related securities because the housing collateral protecting them is worth less.

Moreover, when a company in financial distress begins fire sales of its assets to raise capital to meet regulatory requirements, the market-bottom prices it sells out for become the new standard for the valuation of all similar securities held by other companies under mark-to-market. This has begun a downward death spiral for financial companies large and small.

More foreclosures and home auctions continue to depress housing prices, further reducing the value of all mortgage-related securities. As capital values decline, firms must scramble to maintain the capital required by regulation. When they try to sell assets to raise that capital, the market values of those assets are driven down further. Under mark-to-market, the company must then mark down the value of all of its assets even more.

The credit agencies see declining capital margins, so they downgrade the company's credit ratings. That makes borrowing to meet [capital requirements](#) more difficult. Declining capital and credit ratings cause the company's stock prices to decline.

Panic sets in, and no one wants to buy mortgage-related securities, which drives their value under mark-to-market regulations down toward zero. Balance sheets under mark-to-market suddenly start to show insolvency. This downward spiral shuts down lending to these companies, so they lose all liquidity (cash on hand) needed to keep company operations going. Stockholders--realizing that they will be wiped out if the companies go into bankruptcy or get taken over by the government--start panic selling, even when they know the underlying business of the company is fine.

The end result for the company is stock prices driven toward zero and bankruptcy or government takeover. The criminal liabilities imposed under Sarbanes-Oxley have driven accountants to stricter and stricter accounting evaluations and interpretations and have prevented leading executives from resisting them.