

## E-Memo

**TO:** INVESTORS/MEMBERS/PARTNERS AND FRIENDS  
**FROM:** Jon Bruss  
**DATE:** March 17, 2009  
**SUBJECT:** If FDR did it with the stroke of a pen . . .

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Did you watch the House Financial Services Committee hearing last week? If so, you caught the tongue lashings that panel members administered to the Securities & Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB). The anger of congressmen from both sides of the aisle was palpable. Though we are almost immune to the rabid bloviations of Washington, this time the collective frustration of Mr. Frank's panel hit a meaningful target. The witnesses looked like deer in the headlights. What was it all about? Opponents of mark-to-market accounting (MTM) were finally getting their day in court. We can thank, in part, Brian Wesbury and Bob Stein of First Trust Advisors for their tireless advocacy on this issue and for putting a letter on their website for readers to sign and send to their congressmen (see the last paragraph on the next page).

When Congress is bombarded by enough letters and e-mails, its members respond. The hearing last week was the coda to an argument that began in earnest last fall and culminated with thousands of letters and e-mails from our readers and many others. These missives explained that the Administration and the regulators really had it all wrong and were injecting tax dollars into banks that didn't need the money, if only mark-to-market accounting were deep-sixed. The FASB ended the hearing by agreeing (under duress it appeared) to make some modifications for the banking system within three weeks. Three weeks! The FASB obviously has a tin ear. This body is made up of sophisticated accounting types who are to detect all manner of trends in accounting chicanery and make rules to prevent said evils. This time, they really missed the voices of their clients and their client's public accounting firms and law firms.

Early last fall, William Isaac addressed this issue in the Wall Street Journal:

During the 1980s, our underlying economic problems were far more serious than the economic problems we're facing this time around.... It could have been much worse [in the 1980s]. The country's 10 largest banks were loaded up with Third World debt that was valued in the markets at cents on the dollar. If we had marked those loans to market prices, virtually every one of them would have been insolvent.

Because of years of costly litigation, the accounting profession has little appetite for any rule that is not totally mechanical. In short, FAS 157 (the current statement of mark-to-market accounting policy) serves the profession admirably by removing human judgment and the attendant fallibilities. But FAS 157 ill serves the profession's clients, according to Bill Isaac:

This is contrary to everything we know about bank regulation. When there are temporary impairments of asset values, due to economic and marketplace events, regulators must give institutions an opportunity to survive the temporary impairment. Assets should not be marked to unrealistic fire sale prices. Regulators must evaluate the assets on the basis of their true economic value (a discounted cash flow analysis).

If we had followed today's approach during the 1980s, we would have nationalized all of the major banks in the country, and thousands of additional banks and thrifts would have failed. I have little doubt that the country would have gone from a serious recession into a depression.

Bill Isaac knows whereof he speaks. In the early 1980s, he headed the FDIC and admirably handled the banking crisis then facing this country. His insights are invaluable.

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As much as folks in Washington seem to want to wrap themselves in the mantle of FDR, they must have missed his epiphany of 1938. According to Milton Friedman and Anna Schwartz, authors of *A Monetary History of the United States 1867-1960*, mark-to-market accounting was responsible for many bank failures in the 1930s. Were he alive today, we think Mr. Friedman would remind us that the mistakes of the 1930s are being visited upon us again today. And Roosevelt's epiphany? President Obama could and should take a page from Roosevelt and, like Roosevelt, with the stroke of pen, outlaw mark-to-market accounting—or at the very least put it in mothballs for a while.

One final point: It's too soon to be doing high-fives around the ATM or the bank vault door. We (ALL of our readers) need to keep the heat on Congress by continuing to write letters encouraging them to pressure FASB and the SEC to modify or suspend FAS 157. To do this, please go to: <http://www.ftportfolios.com/Retail/Research/EconomicResearch.aspx>. There you will find two links, one with a letter you can send your senators and congressmen and another link that provides their addresses. It is not too late to thank them for their support (if they are members of the Financial Services Committee) or remind them of that hearing and the outpouring of concern from their fellow congressmen. And remind them that FDR did it with the stroke of a pen.

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**P A R T N E R S**

**C A P I T A L M A N A G E M E N T, L T D.**

**700 Walnut Ridge Drive, Ste 200, Hartland, WI 53029**

**262-369-1095 (Jon Bruss and James Bruss)**

**[www.fortresspartners.com](http://www.fortresspartners.com)**

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