

Goldman a rare voice of sanity at mad bankers' tea party

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HERE'S seldom any joy in praising the mighty. Yet you have to give Goldman Sachs Group credit.

Once again, it is living up to its reputation as the world's smartest bank.

Two weeks ago

New Jersey-based Goldman said it would cut its ties with the Institute of International Finance, a lobby group now best known for floating one of the dumbest regulatory proposals to emerge from the subprime-mortgage debacle.

In doing so, Goldman stands apart as a rare voice of sanity in an industry gone cuckoo.

For months, we've heard one major financial institution after another complain that the real villain behind today's credit problems is mark-to-market accounting, which requires that companies record many assets at their fair value each quarter, rather than at their historical cost.

The best solution for banks, according to this camp, is to change the rules so that their writedowns need not be so big.

The chorus had grown so loud that the Washington-based institute, which calls itself "the world's only global association of financial institutions," sent a 17-page proposal in April to the heads of the US Financial Accounting Standards Board and the London-based International Accounting Standards Board, along with a cover letter practically begging them to overhaul their rules.

Now that Goldman has thrown the institute under the bus, the accounting boards have all the political cover they need to say "no."

NEWS Analysis

Count this as one of the easiest public relations scores on Wall Street in recent memory. With a swift kick, and little risk, the bank that famously shorted the subprime market last year managed again to distance itself from a sickly herd — re-inforcing the widely held notion that there is Goldman, and there is everybody else.

And what a crew everybody else is. Institute board chairman is Josef Ackemann, chairman of Deutsche Bank (write-downs since the beginning of last year \$7.7bn). The first vice-chairman is William Rhodes, senior vice-chairman at Citigroup (\$37.3bn plus \$5.6bn in credit losses). Other subprime losers with executives on the institute's board include Credit Suisse Group (\$9.5bn); Societe Generale (\$6.3bn); American International Group (\$19bn); and HSBC Holdings (\$6.9bn plus \$12.6bn in credit losses).

Quite an illustrious list, if it was still 2006.

The institute, already backpedaling, says it will release a new report next month. In a statement last month, its MD, Charles Dallara, acknowledged the "view that applying new techniques, or greater flexibility, in current circumstances would be fraught with difficulties."

The group's April proposal had two main pieces. The first I call the market-is-nuts defence against booking losses. The problem, in the Institute's words, is that some write-downs required under current accounting rules "may be substantially in excess of any actual or reasonably probable economic loss."

For example, say the market for a given contract becomes

less active suddenly, complicating efforts to assess its value. In such cases, the institute said, companies should be allowed to use estimates of future cash flows to value their holdings until market activity resumes.

So never mind what the asset might fetch in a sale now. Just check the box next to "the market is nuts", and you're free to value it using your own subjective assumptions.

Then there's the institute's second big idea: legalised fibbing. Under this approach, companies could take some securi-

ties in trading accounts, and re-classify them as held-to-maturity, even if they have no intention of actually holding them to maturity.

Such balance-sheet adjustments would be allowed when an asset couldn't be sold "at a price representative of its conservative economic value". The effect would be to let companies freeze the values of those securities.

The companies would be free to sell the securities after a two-year quarantine period, which "should allow the market to

come back to normal trading conditions".

So, to sum up, the solution here is to have companies switch balance-sheet labels and postpone losses by deliberately misstating their intentions.

US rules, by comparison, say companies may classify debt securities as held-to-maturity only if they have "the positive intent and ability to hold those securities to maturity".

Not exactly unreasonable, yet under the institute's proposal these "excessively demanding rules" would be waived.

The institute's suggestions "are seriously flawed", Goldman spokesman Lucas van Praag told me. "Marking to market is an essential risk-management discipline. And we don't accept the premise that it's unhelpful or even impossible to achieve valuations in illiquid markets or during times of market turbulence."

Score another one for Goldman Sachs.

■ *Weil is a Bloomberg News columnist. The opinions expressed are his own.*