‘USE YOUR OWN JUDGMENT’

Mark-to-market accounting – a method that could soon be required for U.S. companies, as set by the industry-run Financial Accounting Standards Board – directs banks and other corporations to value assets by what they’d sell for today. It’s a marked change from “historical cost,” the traditional money-counting method that allows assets to be valued at the price originally paid (until or unless they are sold). That method is still used on portions of many banks’ financial statements.

Mark-to-market, also known as “fair value accounting,” makes a big difference in how a balance sheet looks, and it’s going to matter to community banks in the coming months as the nation winds its way out of financial crisis, says Jim Cataldo, an assistant professor of accounting at Suffolk University’s Sawyer School of Management.

“I am against a wholesale move to fair value,” he said, noting it’s a view he shares with Business School Associate Dean Morris McInnes.

“Fair value is good for measuring solvency at any given moment, but … it’s incompatible with how we understand an institution’s financial performance,” he said during an interview with Banker & Tradesman.

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Q: You’ve been at Suffolk just three years, but in the financial world for 23. Tell us more about your background.

A: I got my Ph.D. in economics from Columbia University in 1985. It was a time when there was a glut of academic economists, so I went to work for my father’s real estate development business in Burlington, Mass. for a few years, and eventually found my opportunity with [federal bank regulator] the Office of Thrift Supervision. They needed someone who could brief them on the regional economy … More of what I did was assist them with bank exams, by modeling interest rate risk portfolios. That was between 1989 and 1991. – it was an exciting time… we were finally taking the authority to address problem savings and loans. Then as the industry consolidated we were shrinking too … my boss let me know about an opportunity at the Federal Home Loan Bank, I was there (through most of the 1990s) trading futures to enhance the bank’s income and help manage its overall risk … That put me in a position to try my hand on the Wall Street side. I was with [bond trader] Cantor Fitzgerald for about a year in the mid-1990s, then went back to FHLB.

Q: With such an array of experience, what’s the most valuable thing you’ve learned?

A: What I tell my students is: Always be in a position to use your own judgment. Be educated and prepared enough so you don’t have to take someone else’s word about what is really going on. Accounting is great for that. Once you know how to evaluate the books, no one else can tell you how the business is doing.

Q: How much more would be enough?

A: No one knows that. But what will cause this to continue to get worse is foreclosures. They destroy value. We need to find a way to moderate them. The TARP investments will help stabilize balance sheets, but will not be enough to help banks actually lend.

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CATALDO’S “FIVE WAYS NOT TO RESOLVE TODAY’S FINANCIAL CRISIS”

1. Don’t view what’s happening [as only affecting] the financial system. If foreclosures continue unabated and housing prices continue to decline, no amount of support to the banking system will be sufficient to restore financial health.

2. Avoid the temptation to micromanage recipients of bank financial support. Yes, the purpose of the support is to free up lending – but not at the cost of recompensing underwriting standards.

3. Don’t blame [mark-to-market] accounting for the crisis … Don’t think pretending bad assets are still worth what banks paid for them will help the situation now.

4. Don’t miss the opportunity to strengthen regulation and oversight, but beware of unintended consequences.

5. Don’t forget we’re all in this together.