Career Limiting Gestures (CLG): Trying to Speak Truth to Congress

William K. Black | Wednesday, May 30, 2012

At the large law firm where I began my professional career we were warned about making "career limiting gestures" (CLGs). I confess to being an expert in committing CLGs, such that I am unemployable in the federal government. I'm a serial whistle blower who blew the whistle too often and too effectively on too many prominent politicians and bosses running my agency. One of the proofs of what a great nation America is capable of being is that I survived and the prominent politicians and agency heads who tried so hard to destroy my career and reputation failed. Indeed, in the process they helped to make me an exemplar that public administration scholars use to illustrate how regulators should function. The latest act of Congress disinviting me from speaking truth to power has caused me to ruminate on CLGs. I have concluded that they are essential to effective regulation.

Regulatory CLGs during the S&L Debacle prevented a Catastrophe

(In my most recent column I described the first time that Congress disinvited me from speaking truth to power. This paragraph and the following paragraph recap that event and are mostly a pure "cut and paste" so if you read the prior article you can skip to paragraph four.) When I was the Deputy Director of FSLIC, House Banking Committee Chairman St Germain was helping Speaker Wright hold the FSLIC recapitalization bill hostage to extort favors for Texas control frauds, including Don Dixon's Vernon Savings (which was providing prostitutes to the State of Texas' top S&L regulator and was building towards having 96% of its ADC loans in default – which is why we referred to it as "Vermin"). The attack on our agency was that we were mad dogs biased against Texas S&Ls and causing the Texas crisis by closing too many insolvent but well-run Texas S&Ls. Our response had many elements, but one of our principal points was that the Texas S&Ls we were closing were typically control frauds. At this juncture, St Germain's staffers made a mistake. They requested that we testify on a host of issues, but the invite letter had a zinger, premised on an article saying that the Feds were slow to prosecute frauds in the Southwest. The invite specifically called for us to respond and discuss the role of fraud in the Southwest. We used the opportunity to explain the extensive role of fraud in Texas S&L failures.

The day of the hearing, I walked toward the witness table, but was called over by St Germain's chief of staff. He proceeded to disinvite us from testifying on the grounds that we had filed non- responsive testimony. (We had, of course, responded to every inquiry

they made. They simply hated the response because we documented the enormous role that control fraud was playing in causing Texas S&Ls to fail.)

The head of our agency, Chairman Gray, made me Deputy Director of FSLIC in January 1987 because he wanted me to take the lead in seeking the recapitalization of the FSLIC fund. We had spent all but $500 million of our FSLIC fund to close as many of the worst frauds as possible.

That $500 million was supposed to insure roughly $1 trillion in industry insured deposits – an industry that was insolvent by roughly $100 billion. Contrary to the Speaker's faux facts, we had spent down the FSLIC fund from $6 billion to $500 million by closing far more California than Texas S&Ls because the Federal Home Loan Bank of San Francisco (FHLBSF) was less overwhelmed than the FHLB Dallas and sent in more receivership recommendations. FSLIC Recap was the agency's top priority because we were running on fumes and woke up every day wondering what we would do if a national run began on S&Ls.

The Speaker, however, was convinced that we were picking on Texas in general and Democrats in particular because he had seen the FBI's subpoena, which requested documents concerning 400 persons of interest in the investigation of fraudulent Texas S&Ls. Speaker Wright was enraged because he recognized many Democrats on the list of 400. He never considered the fact that S&L control frauds would find it useful, and painless, to make large contributions to the Party controlling Congress. One of the most interesting things about the sleazy Texas contributors on whose behalf the Speaker intervened was that they had voted for Ronald Reagan in the 1980 election. They were Democrats solely because Democrats could help them.

Contemporaneously, Keating's business associate and ally, the former Commissioner of S&Ls for California, was writing to President Reagan warning that our closure of California S&Ls would cost the Republican Party any chance to win California in the next election. We were apparently biased against Democrats and Republicans simultaneously.

Actually, the best claim of bias was an S&L in California run by Italian-Americans that we closed. The owners claimed that we were biased against people of Italian descent. The agency's head of supervision, Frank Passarelli, the head of the FHLBSF, James Cirona, the head of supervision for the FHLBSF, Michael Patriarca, and the General Counsel of the FHLBSF, Bill Black (spouse then and now of June Carbone), the four principal actors in the decision to recommend that the S&L be placed in receivership thought it unlikely that anti-Italian-American animus dictated our decision. On a more serious note, our examiners were subjected to death threats by one of the S&L's most senior officers and implicit threats (photographing their license plates) and unknown individuals. Sometimes the CLGs a regulator must undertake to complete one's duty threaten to limit more than one's career.

Speaker Wright took badly to our actions in closing fraudulent Texas S&Ls and our reregulation of the industry – which prevented the debacle from becoming a catastrophe that would have cost over a trillion dollars to resolve. He held the FSLIC recapitalization (FSLIC Recap) bill hostage in order to extort favorable regulatory treatment for the

several of the most fraudulent Texas S&Ls. He had seen me testify many times before Congress. He knew what a snake pit he was throwing me in, he knew I was very young for my position, and he was the leader who decided that passing FSLIC Recap was our top priority. He would never have chosen me if I he had not seen that I was totally non-partisan, friendly, open to hearing other's viewpoint, and calm and steady under fire.

Chairman Gray personally selected me to be part of two key meetings with Congress. The first was a "peace mission" with Speaker Wright. Bob Strauss, the grand old man of the Democratic Party arranged the meeting because he was concerned that Texas S&L frauds were leading the Speaker to take actions that would harm the Speaker and the Democratic Party in the 1986 election. The short version is that the meeting was a disaster. The Speaker was in no mood for peace. He began attacking Chairman Gray, who was not at the meeting, for having "lied" to him about Vernon Savings. Charles Keating's Lincoln Savings was the only S&L worse than Vermin Savings. We were flabbergasted, because we had back channeled to Wright prior to the meeting just how massively fraudulent Vernon Savings was. I was the only one present willing to defend Gray against the Speaker's (completely false) charge that Gray had lied to him about Vernon Savings. The Speaker did not take it well. He began yelling and cursing at me.

After the meeting, I convinced Gray that he should cease giving in to the Speaker's successful use of holding the FSLIC Recap bill hostage to extort regulatory favors for the worst Texas control frauds. The point I made that convinced Gray was that the Speaker's response to successful extortion was to extort ever greater concessions and that continuing to give in to the extortion would destroy the agency's integrity. The last straw for Gray was Wright's request (and a "request" from the Speaker is actually a command) that Gray fire the head of supervision at the FHLB Dallas. Gray had personally recruited Joe Selby, former acting head of the Office of the Comptroller of the Currency (OCC) to head supervision in Dallas. Joe was the most prestigious regulator in America and Gray chose him to bring law and order to our district most beset by control frauds. It was a variant of the old Texas Ranger slogan: "one riot; one Ranger." To lose America's top regulator in the district most desperately in need of regulation would be a disaster for the agency and the nation. It was the reason that Wright gave for wanting to fire Selby was what sickened Gray. Wright claimed that Selby was a homosexual sending all the legal work of the FHLB Dallas to homosexual law firms (a category that didn't exist in Martindale and Hubbell at the time). This was the first time that Gray said "no" to Wright. As he thought about the depths to which Wright was making him descend Gray came to agree with us that he had to confront the Speaker rather than continue to be extorted.

Selby knew that staying as the head of supervision for the FHLB Dallas would end badly. He sacrificed his career and his privacy for the good of the nation through innumerable CLGs.

Naturally, Chairman Gray chose me to explain to the media how the Speaker had been extorting us and why we were finally saying "no." I blew the whistle on Speaker Wright. Equally naturally, the Speaker was enraged when I began to make public his extortion. His response included repeated efforts to get me fired. One of the proposed ethics charges by the independent counsel chosen by the House ethics committee to conduct

the investigation of charges against Speaker Wright was the Speaker's effort to get me fired. Indeed, one of my most successful bipartisan efforts was bringing together Speaker Wright (D. TX) and Charles Keating (prominent Republican donor and sometimes campaign manager) in an effort to get me fired and sued.

Keating hired private detectives twice to investigate me and, after the meeting with Speaker Wright, sued me for $400 million. Keating's infamous July 15, 1987 memo about me mentions Speaker Wright:

"HIGHEST PRIORITY – GET BLACK

GOOD GRIEF – IF YOU CAN'T GET WRIGHT AND CONGRESS TO GET BLACK – KILL HIM DEAD – YOU OUGHT TO RETIRE. (Punctuation and emphasis as in the original.)

One of the attachments Keating made to this memo was a news article in which I criticized the Speaker for his extortion.

The other meeting that Chairman Gray personally asked me to attend was the April 9, 1987 meeting that later gave the name to the "Keating Five" – the five U.S. Senators who intervened on behalf of the most fraudulent S&L in the nation, Charles Keating's Lincoln Savings to seek to prevent us from taking enforcement action against Lincoln Savings commission of the largest and most costly rule violation in the history of the agency. I took the exceptionally detailed notes of the meeting that led to the Senate ethics investigation of the Keating Five. Four of the five U.S. Senators at the meeting were Democrats. Senator McCain was the lone Republican.

Three things are important about the meeting and relevant to the recent decision to disinvite me from briefing Members of Congress about derivatives. First, we said "no" to the five Senators. Flat out – no. Indeed, we told them that we were filing a criminal referral against the top officers at Lincoln Savings. The Senators had exceptional leverage over us because we had just lost badly in the House on the size and nature of FSLIC Recap and our only hope for success on our agency's top priority was the Senate and we could not succeed in the Senate absent support from the Keating Five.

Second, consider this exchange between Senator DeConcini and Michael Patriarca at the Keating Five meeting. (I have edited it slightly for the sake of brevity, but it is important to know that during the exchange Patriarca informed the Senators that we were making a criminal referral against Lincoln Savings' senior officers. Patriarca also explained that the S&L's outside auditor, Arthur Young, had given a "clean" audit opinion despite an accounting treatment that allowed an absurd $12 million revenue recognition for a deal that was unwound.)

McCAIN: Why would Arthur Young say these things about the exam - that it was inordinately long and bordered on harassment?

DECONCINI: Why would Arthur Young say these things? They have to guard their credibility too. They put the firm's neck out with this letter.

PATRIARCA: They have a client.

DECONCINI: You believe they'd prostitute themselves for a client?

PATRIARCA: Absolutely. It happens all the time.

Note that DeConcini phrased his question in a manner designed to force Patriarca to back off his criticism of Arthur Young (AY) – what regulator would dare tell a group of U.S. Senators that AY, one of the most prestigious audit firms in the world, would act as a "prostitute"? I cannot convey to you how startled the Senators were by Patriarca's response. They expected to be leaning on four field regulators. Five U.S. Senators against four regional bureaucrats is equivalent to the sending the NBA champions, playing at home, against an NCAA Division III college basketball team. The Senators had clearly never seen anything like us. Patriarca was always an outstanding leader, but this was his finest five minutes.

Notice that Patriarca is calm and professional throughout, but he is also blunt and un-bureaucratic. He does confront the Senators when they try to force him to accept an untruth as a truth. He speaks uncomfortable truth to power. He was correct. The Senators were wrong. There is no credible dispute about those facts today.

Here is the key fact that Speaker Wright and the Keating Five never understood. At both the peace meeting and the Keating Five meeting we, the regulators, were the only and best friends of the elected officials who met with us. We were the only ones who were non-partisan and who would tell them the truth. Vermin and Lincoln Savings' officials were congenital liars because control frauds cannot tell the truth. Most regulators will not speak truth to power. They are too afraid of the consequences because the politically powerful frequently seek to kill the honest messenger. There is no greater service a regulator can do in these circumstances than have the integrity and courage to speak truth to power and we gave this supreme gift to Speaker Wright and the Keating Five along with the gift of professionalism and the willingness and ability to speak bluntly and in plain English. Naturally, they generally reacted by becoming enraged.

The third factor only dawned on me a full decade after the Keating Five meeting. It dawned on me so slowly because we considered the factor so normal in our era that we paid it no conscious attention. We were apolitical as regulators. I worked closely in the same regional office for years with my three regulatory colleagues who I joined in attending the Keating Five meeting. I did not then, and do not now, know their political affiliation (if any). We went after the S&L frauds and their political cronies regardless of party. We wanted to root out all the control frauds regardless of party and we wanted to help the Justice Department convict them of felonies and imprison them.

The first Bush administration and the Clinton administration both sent representatives to Japan to urge them to emulate the cleanup of the S&L debacle, which they cited as the best available model for addressing a developing financial crisis. The second Bush administration and the Obama administration have taken the position that there is nothing useful to be learned from the S&L debacle, which they consider ancient history. This is one of the reasons they both failed so badly to reregulate the industry in a timely

fashion and to hold the elite control frauds that drove the ongoing crisis accountable for their crimes. It is exceptionally arrogant, foolish, and destructive to fail to learn from the successes of the past.

Experts in public administration have cited our work in countering the surging growth of the S&L crisis through rapid reregulation that we undertook despite the violent opposition of the frauds, the trade association, and their political allies in Congress and the administration. They have not found anything worthy of praise in "modern" financial regulation. "Modern" regulation is actually archaic non-regulation premised on the dogma that markets are "self-correcting' and automatically exclude fraud.

Chairman Gray began reregulating the industry in 1983 – one year after the passage of key federal deregulation law, the Garn-St Germain Act of 1982. That Act was passed with only one nay vote in each chamber, so Gray's action was all the more extraordinary. Gray knew from the day he began to reregulate that he was destroying his career. He was not a confrontational person. He would have loved to have found a course of conduct that did not require him to engage in constant CLGs. He concluded that there was no way to be true to his oath of office if he did not reregulate. Gray knew that the ultimate curse in the Reagan administration was to call someone a "reregulator," but he made that CLG for the nation.

In the current crisis, the equivalent to Gray's speed in reregulating would have required vigorous reregulation to begin in 1994. Deregulation began in the Clinton administration in 1993 through the replacement of underwriting rules with unenforceable guidelines pursuant to the "reinventing government" movement. I personally witnessed (and strongly protested) Washington, D.C. officials of our agency instructing the field that we were to refer to the industry as our "clients" and think of them as our clients. That mindset makes effective regulation impossible.

The pressure on Gray not to go forward with reregulation was exceptional – in some ways greater than the despicable attack on Brooksley Born when she, as CFTC Chair, was prevented from adopting the rules she rightly warned were essential to protect the global financial system from the risks of credit default swaps (CDS). Like Gray, she went forward even after knowing that her attempts to protect the nation had been an enormous CLG.

If someone has the money and the academic forum, I urge them to hold a conference now to honor Mr. Gray and Ms. Born for their service to the nation and the costs they bore for us by making their CLGs. I urge a conference that takes seriously and investigates the questions of what works in regulation and how we can select regulatory leaders with the integrity to take vigorous actions to prevent or limit crises. I would add praise for the efforts of the late Federal Reserve Board Member Gramlich who tried to convince Alan Greenspan to act against the "green slime" (endemically fraudulent "liar's" loans and collateralized debt obligations (CDOs) (not) "backed" largely by the liar's loans). Gramlich did not push the point to CLG levels. If Greenspan had acted on Gramlich's advice, however, we could have avoided the financial crisis. The Federal Reserve – and only the Fed – had the statutory authority under the Home Ownership and Equity Protection Act of 1994 (HOEPA) to ban all lenders (even those who were not

federally insured) from making liar's loans. Bernanke also refused to use the HOEPA authority to bar what he knew to be endemically fraudulent liar's loans until he

finally succumbed to Congressional pressure on July 14, 2008 – and even then he substantially delayed the effective date of the prohibition on liar's loans. We wouldn't want to inconvenience endemically fraudulent lenders – even after they were leading drivers of the Great Recession.

The spread of anti-regulatory dogmas that deny the existence of fraud among economists and the anti-regulators Bush and Obama have appointed to key regulatory leadership positions has caused grave damage. Indeed, because America's leading export to Europe is theoclassical economics and economists we have exported anti-regulatory dogmas throughout the much of Europe.

Who on the panel briefing Congress is more non-partisan than me?

During the current crisis I have been called to testify five times by Congress: by the Senate on financial derivatives, the role of fraud in driving the crisis, and the failure to prosecute and the House on executive compensation and the failure of Lehman managers and regulators. I was asked to testify three times by Democrats and the last two times by Republicans. Anyone who reads my columns knows that my criticism is not limited to members of any particular political party.

As an academic, I am even freer to speak truth to power. I do not care which Party or politicians my comments may support or criticize. As an agency official I had institutional responsibilities at times to represent the position of the head of the agency. As an academic I have total freedom to give people my best advice. I have a 30 year track record of apolitical public policy implementation and advice. I have brought elite Democrats and Republicans to justice with equal zeal. OFHEO, the agency run by one of President Bush's oldest friends, retained me as an expert in its administrative enforcement action against a prominent Democrat, Franklin Raines (Fannie Mae's former CEO).

Tuesday, May 29, 2012, I received definitive word that I had been disinvited from a bipartisan briefing of members of Congress on the subject of financial derivatives. The stated grounds were that my participation would upset the bipartisan "consensus" as to the necessary "balance" of the panel and threaten to cause the banks to withdraw from the briefing because they fear that I would be "confrontational" and engage in "bank bashing."

As last communicated to me by congressional staff, the briefing panel will consist of the following individuals:

Wallace Turbeville – Senior Fellow, Demos (Formerly of Goldman Sachs)

John Parsons – Senior Lecturer in Finance, MIT

Nela Richardson – Senior Economic Analyst, Bloomberg Government (formerly of Freddie Mac and the Commodities Futures Trading Commission)

Marcus Stanley – Policy Director, Americans for Financial Reform (AFR)

Chris Young – International Swaps and Derivatives Association (ISDA)

Mark Calabria – Dir. Of Financial Regulation Studies, CATO Institute

I am delighted that Congress is going to hear from these individuals. I think a breadth of views is important. It is important, however, to realize the perspectives being lost. It appears that I would have been the only one with experience as a regulator on the panel. (Dr. Richardson worked briefly for a regulatory agency as an economist. I have been unable to find a bio for Chris Young.) I would have been the only criminologist on the panel. I would suggest that this is the most relevant single area of expertise to understand the role derivatives played in the ongoing crisis. (I know that strikes most economists as preposterous – that proves my point about the lost perspective. It amazes me that economists who do not study fraud know that it did not occur. One of the panelists co-authored a 200+ page study on the rise and fall of nonprime loans. A search of the document revealed no reference to "fraud" or "crime.") I would have been the only person on the panel who had served as an expert witness in the prosecution of financial frauds, to train AUSAs and FBI agents in how to prosecute and investigate complex frauds involving criminal referrals, and the only person ever to take a significant role in making a criminal referral concerning criminal referrals, or placing a problem bank in receivership or conservatorship.

I would have been the only person on the panel from the heartland. It appears that I would have been the only ex-banker for a bank in the Western U.S. (everyone else appears to be based on the east coast).

I believe that I would have been the only person on the panel who had taught classes in how to conduct effective financial regulation. I would have been the most multidisciplinary member of the panel, combining economics, law, criminology, (some) accounting (critical to understanding why derivatives proved to be such attractive "green slime" that three of the largest investment banks held enormous positions in CDOs they knew were (not) "backed" by endemically fraudulent "liar's loans), public administration, and regulatory expertise. Multidisciplinary analysis offers unique perspectives that cannot be provided even by a panel that has mono- disciplinary experts from multiple fields. I would have been the only member of the panel with experience concerning the S&L debacle, which has many lessons for the current crisis and the abuse of financial derivatives. I would have been the only member of the panel with the experience of serving in a material role in a national commission tasked with determining the causes of a prior crisis and making policy recommendations to reduce the risk of future crises.

I also have unusual expertise with the role, or non-role of financial derivatives in other nations' financial crises because I have been invited to Iceland, Ireland, Italy, France, and Spain to discuss the causes of their crises and appropriate public policy responses. I have been invited to Switzerland, Monaco, and the U.N. General Assembly's recent "high level thematic debate" on finance to discuss the overall euro zone crises.

Time will tell whether culling speakers viewed as too likely to criticize the largest banks will lead to a reduction in speaking truth to power at the briefing. We can say now, however, that the cull sends a chilling message that if one wishes to be allowed to be part of the discussion with those in power it pays not to have a reputation for speaking truth to power. I argue that the fear of speaking the truth about the dangers to the nation and the global economy posed by

systemically dangerous institutions (SDIs) engaging in proprietary gambling (or, worse, fraud) in financial derivatives is the central reason we have failed to end the gravest risk that will cause our next catastrophic financial crisis. It was the SDIs' bets and frauds in financial derivatives that largely drove the ongoing crisis. If Members of Congress believe that the positions I have just articulated constitute "bank bashing" then we have allowed honest debate to be blinded by rhetorical camouflage. The SDIs are not entitled to prevent us from presenting the facts that persuasively support each of the substantive points I have made in this paragraph. I would have presented those facts in my briefing.

I continue to urge conservatives and libertarians to join us in demanding that the SDIs, who receive implicit federal subsidies equivalent to Fannie and Freddie, should be shrunk to the point where they no longer pose a systemic risk to the global economy and are no longer treated as "too big to fail" (which is what generates the implicit federal subsidy). The SDIs are the modern face of crony capitalism that cripples free markets and democracy. That's a "consensus" that Congress should embrace. The Members will not even consider doing so, however, unless they hear progressives, conservatives, and libertarians speak those truths to power. I urge the members of the panel who will be allowed to brief the Members to start with these basic truths.

Going public with being disinvited by Congress is a clear CLG and there will be painful consequences. As you saw in the email thread if you read my prior column, they dangled the prospect of speaking at future panels if I would just not rock the boat. That's the bait. But the key is that you have to not care whether they ever ask you to testify again. Every one of my regulatory colleagues that I respect committed multiple CLGs. Ed Gray is unemployed and unemployable – and has been for two decades. But he doesn't have to avoid mirrors and he'd do it again today.

Let's demand that the President appoint regulatory leaders with a record of making CLGs

So here is the test for President Obama in his second term or President Romney should he win: check whether they will make the most effective financial regulator in America the head of the Office of the Comptroller of the Currency. His name is Michael Patriarca. Give him the mandate to shrink the SDIs and supervise them ultra-intensively until they have shrunk to the size that they no longer pose a systemic risk. I guarantee that he will commit a host of CLGs by speaking truth to power and saying "no" to the SDIs. It is a national scandal that neither President Bush nor President Obama called on Patriarca. We need regulatory professionals with track records of success, of integrity, of fearlessness, of CLGs, and of speaking truth to power. The right and left seem to agree that regulation is impossible. They have not seen a regulatory head, with the exception of Brooksley Born, since Ed Gray willing to commit a CLG that will destroy her career in

order to fulfill her oath of office. Gray did so a quarter-century ago. Born did so nearly 15 years ago. If you want successful regulators, search for those with a track record of making repeated CLGs whenever it is necessary to fulfill their duty to the nation.

William K. Black, J.D., Ph.D. is Associate Professor of Law and Economics at the University of Missouri-Kansas City. Bill Black has testified before the Senate Agricultural Committee on the regulation of financial derivatives and House Governance Committee on the regulation of executive compensation. He was interviewed by Bill Moyers on PBS, which went viral. He gave an invited lecture at UCLA's Hammer Institute which, when the video was posted on the web, drew so many "hits" that it crashed the UCLA server. He appeared extensively in Michael Moore's most recent documentary: "Capitalism: A Love Story." He was featured in the Obama campaign release discussing Senator McCain's role in the "Keating Five." (Bill took the notes of that meeting that led to the Senate Ethics investigation of the Keating Five. His testimony was highly critical of all five Senators' actions.) He is a frequent guest on local, national, and international television and radio and is quoted as an expert by the national and international print media nearly every week. He was the subject of featured interviews in Newsweek, Barron's, and Village Voice.