Moyers Journal: Madoff Was A Piker -- America's Big Banks Are a Far Larger Fraudulent Ponzi Scheme

By Bill Moyers, Bill Moyers Journal
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Bill Moyers: For months now, revelations of the wholesale greed and blatant transgressions of Wall Street have reminded us that "The Best Way to Rob a Bank Is to Own One." In fact, the man you're about to meet wrote a book with just that title. It was based upon his experience as a tough regulator during one of the darkest chapters in our financial history: the savings and loan scandal in the late 1980s.

Bill Black was in New York for a conference at the John Jay College of Criminal Justice where scholars and journalists gathered to ask the question, "How do they get away with it?" Well, no one has asked that question more often than Bill Black. The former Director of the Institute for Fraud Prevention now teaches Economics and Law at the University of Missouri, Kansas City. During the savings and loan crisis, it was Black who accused then-house speaker Jim Wright and five US Senators, including John Glenn and John McCain, of doing favors for the S&L's in exchange for contributions and other perks. The senators got off with a slap on the wrist, but so enraged was one of those bankers, Charles Keating -- after whom the senate's so-called "Keating Five" were named -- he sent a memo that read, in part, "get Black -- kill him dead." Metaphorically, of course. Of course. Now Black is focused on an even greater scandal, and he spares no one -- not even the President he worked hard to elect, Barack Obama. But his main targets are the Wall Street barons, heirs of an earlier generation whose scandalous rip-offs of wealth back in the 1930s earned them comparison to Al Capone and the mob, and the nickname "banksters." Bill Black, welcome to the Journal.

William K. Black: Thank you.

Bill Moyers: I was taken with your candor at the conference here in New York to hear you say that this crisis we're going through, this economic and financial meltdown is driven by fraud. What's your definition of fraud?

Black: Fraud is deceit. And the essence of fraud is, "I create trust in you, and then I betray that trust, and get you to give me something of value." And as a result, there's no more effective acid against trust than fraud, especially fraud by top elites, and that's what we have.

Moyers: In your book, you make it clear that calculated dishonesty by people in charge is at the heart of most large corporate failures and scandals, including, of course, the S&L, but is that true? Is that what you're saying here, that it was in the boardrooms and the CEO offices where this fraud began?

Black: Absolutely.

Moyers: How did they do it? What do you mean?

Black: Well, the way that you do it is to make really bad loans, because they pay better. Then you grow extremely rapidly, in other words, you're a Ponzi-like scheme. And the third thing you do is we call it leverage. That just means borrowing a lot of money, and the combination creates a situation where you have guaranteed record profits in the early years. That makes you rich, through the bonuses that modern executive compensation has produced. It also makes it inevitable that there's going to be a disaster down the road.

Moyers: So you're suggesting, saying that CEOs of some of these banks and mortgage firms in order to increase their own personal income, deliberately set out to make bad loans?

Black: Yes.

Moyers: How do they get away with it? I mean, what about their own checks and balances in the company? What about their accounting divisions?

Black: All of those checks and balances report to the CEO, so if the CEO goes bad, all of the checks and balances are easily overcome. And the art form is not simply to defeat those internal controls, but to suborn them, to turn them into your greatest allies. And the bonus programs are exactly how you do that.

Moyers: If I wanted to go looking for the parties to this, with a good bird dog, where would you send me?

Black: Well, that's exactly what hasn't happened. We haven't looked, all right? The Bush Administration essentially got rid of regulation, so if nobody was looking, you were able to do this with impunity and that's exactly what happened. Where would you look? You'd look at the specialty lenders. The lenders that did almost all of their work in the sub-prime and what's called Alt-A, liars' loans.

Moyers: Yeah. Liars' loans--

Black: Liars' loans.

Moyers: Why did they call them liars' loans?

Black: Because they were liars' loans.

Moyers: And they knew it?

Black: They knew it. They knew that they were frauds.

Black: Liars' loans mean that we don't check. You tell us what your income is. You tell us what your job is. You tell us what your assets are, and we agree to believe you. We won't check on any of those things. And by the way, you get a better deal if you inflate your income and your job history and your assets.

Moyers: You think they really said that to borrowers?

Black: We know that they said that to borrowers. In fact, they were also called, in the trade, ninja loans.

Moyers: Ninja?

Black: Yeah, because no income verification, no job verification, no asset verification.

Moyers: You're talking about significant American companies.

Black: Huge! One company produced as many losses as the entire Savings and Loan debacle.

Moyers: Which company?

Black: IndyMac specialized in making liars' loans. In 2006 alone, it sold $80 billion dollars of liars' loans to other companies. $80 billion.

Moyers: And was this happening exclusively in this sub-prime mortgage business?

Black: No, and that's a big part of the story as well. Even prime loans began to have non-verification. Even Ronald Reagan, you know, said, "Trust, but verify." They just gutted the verification process. We know that will produce enormous fraud, under economic theory, criminology theory, and two thousand years of life experience.

Moyers: Is it possible that these complex instruments were deliberately created so swindlers could exploit them?

Black: Oh, absolutely. This stuff, the exotic stuff that you're talking about was created out of things like liars' loans, that were known to be extraordinarily bad. And now it was getting triple-A ratings. Now a triple-A rating is supposed to mean there is zero credit risk. So you take something that not only has significant, it has crushing risk. That's why it's toxic. And you create this fiction that it has zero risk. That itself, of course, is a fraudulent exercise. And again, there was nobody looking, during the Bush years. So finally, only a year ago, we started to have a Congressional investigation of some of these rating agencies, and it's scandalous what came out. What we know now is that the rating agencies never looked at a single loan file. When they finally did look, after the markets had completely collapsed, they found, and I'm quoting Fitch, the smallest of the rating agencies, "the results were disconcerting, in that there was the appearance of fraud in nearly every file we examined."

Moyers: So if your assumption is correct, your evidence is sound, the bank, the lending company, created a fraud. And the ratings agency that is supposed to test the value of these assets knowingly entered into the fraud. Both parties are committing fraud by intention.

Black: Right, and the investment banker that -- we call it pooling -- puts together these bad mortgages, these liars' loans, and creates the toxic waste of these derivatives. All of them do that. And then they sell it to the world and the world just thinks because it has a triple-A rating it must actually be safe. Well, instead, there are 60 and 80 percent losses on these things, because of course they, in reality, are toxic waste.

Moyers: You're describing what Bernie Madoff did to a limited number of people. But you're saying it's systemic, a systemic Ponzi scheme.

Black: Oh, Bernie was a piker. He doesn't even get into the front ranks of a Ponzi scheme…

Moyers: But you're saying our system became a Ponzi scheme.

Black: Our system…

Moyers: Our financial system…

Black: Became a Ponzi scheme. Everybody was buying a pig in the poke. But they were buying a pig in the poke with a pretty pink ribbon, and the pink ribbon said, "Triple-A."

Moyers: Is there a law against liars' loans?

Black: Not directly, but there, of course, many laws against fraud, and liars' loans are fraudulent.

Moyers: Because…

Black: Because they're not going to be repaid and because they had false representations. They involve deceit, which is the essence of fraud.

Moyers: Why is it so hard to prosecute? Why hasn't anyone been brought to justice over this?

Black: Because they didn't even begin to investigate the major lenders until the market had actually collapsed, which is completely contrary to what we did successfully in the Savings and Loan crisis, right? Even while the institutions were reporting they were the most profitable savings and loan in America, we knew they were frauds. And we were moving to close them down. Here, the Justice Department, even though it very appropriately warned, in 2004, that there was an epidemic…

Moyers: Who did?

Black: The FBI publicly warned, in September 2004 that there was an epidemic of mortgage fraud, that if it was allowed to continue it would produce a crisis at least as large as the Savings and Loan debacle. And that they were going to make sure that they didn't let that happen. So what goes wrong? After 9/11, the attacks, the Justice Department transfers 500 white-collar specialists in the FBI to national terrorism. Well, we can all understand that. But then, the Bush administration refused to replace the missing 500 agents. So even today, again, as you say, this crisis is 1000 times worse, perhaps, certainly 100 times worse, than the Savings and Loan crisis. There are one-fifth as many FBI agents as worked the Savings and Loan crisis.

Moyers: You talk about the Bush administration. Of course, there's that famous photograph of some of the regulators in 2003, who come to a press conference with a chainsaw suggesting that they're going to slash, cut business loose from regulation, right?

Black: Well, they succeeded. And in that picture, by the way, the other -- three of the other guys with pruning shears are the…

Moyers: That's right.

Black: They're the trade representatives. They're the lobbyists for the bankers. And everybody's grinning. The government's working together with the industry to destroy regulation. Well, we now know what happens when you destroy regulation. You get the biggest financial calamity of anybody under the age of 80.

Moyers: But I can point you to statements by Larry Summers, who was then Bill Clinton's Secretary of the Treasury, or the other Clinton Secretary of the Treasury, Rubin. I can point you to suspects in both parties, right?

Black: There were two really big things, under the Clinton administration. One, they got rid of the law that came out of the real-world disasters of the Great Depression. We learned a lot of things in the Great Depression. And one is we had to separate what's called commercial banking from investment banking. That's the Glass-Steagall law. But we thought we were much smarter, supposedly. So we got rid of that law, and that was bipartisan. And the other thing is we passed a law, because there was a very good regulator, Brooksley Born, that everybody should know about and probably doesn't. She tried to do the right thing to regulate one of these exotic derivatives that you're talking about. We call them C.D.F.S. And Summers, Rubin, and Phil Gramm came together to say not only will we block this particular regulation. We will pass a law that says you can't regulate. And it's this type of derivative that is most involved in the AIG scandal. AIG all by itself, cost the same as the entire Savings and Loan debacle.

Moyers: What did AIG contribute? What did they do wrong?

Black: They made bad loans. Their type of loan was to sell a guarantee, right? And they charged a lot of fees up front. So, they booked a lot of income. Paid enormous bonuses. The bonuses we're thinking about now, they're much smaller than these bonuses that were also the product of accounting fraud. And they got very, very rich. But, of course, then they had guaranteed this toxic waste. These liars' loans. Well, we've just gone through why those toxic waste, those liars' loans, are going to have enormous losses. And so, you have to pay the guarantee on those enormous losses. And you go bankrupt. Except that you don't in the modern world, because you've come to the United States, and the taxpayers play the fool. Under Secretary Geithner and under Secretary Paulson before him… we took $5 billion dollars, for example, in U.S. taxpayer money. And sent it to a huge Swiss Bank called UBS. At the same time that that bank was defrauding the taxpayers of America. And we were bringing a criminal case against them. We eventually get them to pay a $780 million fine, but wait, we gave them $5 billion. So, the taxpayers of America paid the fine of a Swiss Bank. And why are we bailing out somebody who that is defrauding us?

Moyers: And why…

Black: How mad is this?

Moyers: What is your explanation for why the bankers who created this mess are still calling the shots?

Black: Well, that, especially after what's just happened at G.M., that's… it's scandalous.

Moyers: Why are they firing the president of G.M. and not firing the head of all these banks that are involved?

Black: There are two reasons. One, they're much closer to the bankers. These are people from the banking industry. And they have a lot more sympathy. In fact, they're outright hostile to autoworkers, as you can see. They want to bash all of their contracts. But when they get to banking, they say, contracts, sacred.' But the other element of your question is we don't want to change the bankers, because if we do, if we put honest people in, who didn't cause the problem, their first job would be to find the scope of the problem. And that would destroy the cover up.

Moyers: The cover up?

Black: Sure. The cover up.

Moyers: That's a serious charge.

Black: Of course.

Moyers: Who's covering up?

Black: Geithner is charging, is covering up. Just like Paulson did before him. Geithner is publicly saying that it's going to take $2 trillion -- a trillion is a thousand billion -- $2 trillion taxpayer dollars to deal with this problem. But they're allowing all the banks to report that they're not only solvent, but fully capitalized. Both statements can't be true. It can't be that they need $2 trillion, because they have masses losses, and that they're fine. These are all people who have failed. Paulson failed, Geithner failed. They were all promoted because they failed, not because…

Moyers: What do you mean?

Black: Well, Geithner has, was one of our nation's top regulators, during the entire subprime scandal, that I just described. He took absolutely no effective action. He gave no warning. He did nothing in response to the FBI warning that there was an epidemic of fraud. All this pig in the poke stuff happened under him. So, in his phrase about legacy assets. Well he's a failed legacy regulator.

Moyers: But he denies that he was a regulator. Let me show you some of his testimony before Congress. Take a look at this. TIMOTHY GEITHNER:I've never been a regulator, for better or worse. And I think you're right to say that we have to be very skeptical that regulation can solve all of these problems. We have parts of our system that are overwhelmed by regulation. Overwhelmed by regulation! It wasn't the absence of regulation that was the problem, it was despite the presence of regulation you've got huge risks that build up.

Black: Well, he may be right that he never regulated, but his job was to regulate. That was his mission statement.

Moyers: As?

Black: As president of the Federal Reserve Bank of New York, which is responsible for regulating most of the largest bank holding companies in America. And he's completely wrong that we had too much regulation in some of these areas. I mean, he gives no details, obviously. But that's just plain wrong.

Moyers: How is this happening? I mean why is it happening?

Black: Until you get the facts, it's harder to blow all this up. And, of course, the entire strategy is to keep people from getting the facts.

Moyers: What facts?

Black: The facts about how bad the condition of the banks is. So, as long as I keep the old CEO who caused the problems, is he going to go vigorously around finding the problems? Finding the frauds?

Moyers: You--

Black: Taking away people's bonuses?

Moyers: To hear you say this is unusual because you supported Barack Obama, during the campaign. But you're seeming disillusioned now.

Black: Well, certainly in the financial sphere, I am. I think, first, the policies are substantively bad. Second, I think they completely lack integrity. Third, they violate the rule of law. This is being done just like Secretary Paulson did it. In violation of the law. We adopted a law after the Savings and Loan crisis, called the Prompt Corrective Action Law. And it requires them to close these institutions. And they're refusing to obey the law.

Moyers: In other words, they could have closed these banks without nationalizing them?

Black: Well, you do a receivership. No one -- Ronald Reagan did receiverships. Nobody called it nationalization.

Moyers: And that's a law?

Black: That's the law.

Moyers: So, Paulson could have done this? Geithner could do this?

Black: Not could. Was mandated--

Moyers: By the law.

Black: By the law.

Moyers: This law, you're talking about.

Black: Yes.

Moyers: What the reason they give for not doing it?

Black: They ignore it. And nobody calls them on it.

Moyers: Well, where's Congress? Where's the press? Where--

Black: Well, where's the Pecora investigation?

Moyers: The what?

Black: The Pecora investigation. The Great Depression, we said, "Hey, we have to learn the facts. What caused this disaster, so that we can take steps, like pass the Glass-Steagall law, that will prevent future disasters?" Where's our investigation? What would happen if after a plane crashes, we said, "Oh, we don't want to look in the past. We want to be forward looking. Many people might have been, you know, we don't want to pass blame. No. We have a nonpartisan, skilled inquiry. We spend lots of money on, get really bright people. And we find out, to the best of our ability, what caused every single major plane crash in America. And because of that, aviation has an extraordinarily good safety record. We ought to follow the same policies in the financial sphere. We have to find out what caused the disasters, or we will keep reliving them. And here, we've got a double tragedy. It isn't just that we are failing to learn from the mistakes of the past. We're failing to learn from the successes of the past.

Moyers: What do you mean?

Black: In the Savings and Loan debacle, we developed excellent ways for dealing with the frauds, and for dealing with the failed institutions. And for 15 years after the Savings and Loan crisis, didn't matter which party was in power, the U.S. Treasury Secretary would fly over to Tokyo and tell the Japanese, "You ought to do things the way we did in the Savings and Loan crisis, because it worked really well. Instead you're covering up the bank losses, because you know, you say you need confidence. And so, we have to lie to the people to create confidence. And it doesn't work. You will cause your recession to continue and continue." And the Japanese call it the lost decade. That was the result. So, now we get in trouble, and what do we do? We adopt the Japanese approach of lying about the assets. And you know what? It's working just as well as it did in Japan.

Moyers: Yeah. Are you saying that Timothy Geithner, the Secretary of the Treasury, and others in the administration, with the banks, are engaged in a cover up to keep us from knowing what went wrong?

Black: Absolutely.

Moyers: You are.

Black: Absolutely, because they are scared to death. All right? They're scared to death of a collapse. They're afraid that if they admit the truth, that many of the large banks are insolvent. They think Americans are a bunch of cowards, and that we'll run screaming to the exits. And we won't rely on deposit insurance. And, by the way, you can rely on deposit insurance. And it's foolishness. All right? Now, it may be worse than that. You can impute more cynical motives. But I think they are sincerely just panicked about, "We just can't let the big banks fail." That's wrong.

Moyers: But what might happen, at this point, if in fact they keep from us the true health of the banks?

Black: Well, then the banks will, as they did in Japan, either stay enormously weak, or Treasury will be forced to increasingly absurd giveaways of taxpayer money. We've seen how horrific AIG -- and remember, they kept secrets from everyone.

Moyers: A.I.G. did?

Black: What we're doing with -- no, Treasury and both administrations. The Bush administration and now the Obama administration kept secret from us what was being done with AIG. AIG was being used secretly to bail out favored banks like UBS and like Goldman Sachs. Secretary Paulson's firm, that he had come from being CEO. It got the largest amount of money. $12.9 billion. And they didn't want us to know that. And it was only Congressional pressure, and not Congressional pressure, by the way, on Geithner, but Congressional pressure on AIG. Where Congress said, "We will not give you a single penny more unless we know who received the money." And, you know, when he was Treasury Secretary, Paulson created a recommendation group to tell Treasury what they ought to do with AIG. And he put Goldman Sachs on it.

Moyers: Even though Goldman Sachs had a big vested stake.

Black: Massive stake. And even though he had just been CEO of Goldman Sachs before becoming Treasury Secretary. Now, in most stages in American history, that would be a scandal of such proportions that he wouldn't be allowed in civilized society.

Moyers: Yeah, like a conflict of interest, it seems.

Black: Massive conflict of interests.

Moyers: So, how did he get away with it?

Black: I don't know whether we've lost our capability of outrage. Or whether the cover up has been so successful that people just don't have the facts to react to it.

Moyers: Who's going to get the facts?

Black: We need some chairmen or chairwomen--

Moyers: In Congress.

Black: --in Congress, to hold the necessary hearings. And we can blast this out. But if you leave the failed CEOs in place, it isn't just that they're terrible business people, though they are. It isn't just that they lack integrity, though they do. Because they were engaged in these frauds. But they're not going to disclose the truth about the assets.

Moyers: And we have to know that, in order to know what?

Black: To know everything. To know who committed the frauds. Whose bonuses we should recover. How much the assets are worth. How much they should be sold for. Is the bank insolvent, such that we should resolve it in this way? It's the predicate, right? You need to know the facts to make intelligent decisions. And they're deliberately leaving in place the people that caused the problem, because they don't want the facts. And this is not new. The Reagan Administration's central priority, at all times, during the Savings and Loan crisis, was covering up the losses.

Moyers: So, you're saying that people in power, political power, and financial power, act in concert when their own behinds are in the ringer, right?

Black: That's right. And it's particularly a crisis that brings this out, because then the class of the banker says, "You've got to keep the information away from the public or everything will collapse. If they understand how bad it is, they'll run for the exits."

Moyers: Yeah, and this week in New York, at this conference, you described this as more than a financial crisis. You called it a moral crisis.

Black: Yes.

Moyers: Why?

Black: Because it is a fundamental lack of integrity. But also because, if you look back at crises, an economist who is also a presidential appointee, as a regulator in the Savings and Loan industry, right here in New York, Larry White, wrote a book about the Savings and Loan crisis. And he said, you know, one of the most interesting questions is why so few people engaged in fraud? Because objectively, you could have gotten away with it. But only about ten percent of the CEOs, engaged in fraud. So, 90 percent of them were restrained by ethics and integrity. So, far more than law or by F.B.I. agents, it's our integrity that often prevents the greatest abuses. And what we had in this crisis, instead of the Savings and Loan, is the most elite institutions in America engaging or facilitating fraud.

Moyers: This wound that you say has been inflicted on American life. The loss of worker's income. And security and pensions and future happened, because of the misconduct of a relatively few, very well-heeled people, in very well-decorated corporate suites, right?

Black: Right.

Moyers: It was relatively a handful of people.

Black: And their ideologies, which swept away regulation. So, in the example, regulation means that cheaters don't prosper. So, instead of being bad for capitalism, it's what saves capitalism. "Honest purveyors prosper" is what we want. And you need regulation and law enforcement to be able to do this. The tragedy of this crisis is it didn't need to happen at all.

Moyers: When you wake in the middle of the night, thinking about your work, what do you make of that? What do you tell yourself?

Black: There's a saying that we took great comfort in. It's actually by the Dutch, who were fighting this impossible war for independence against what was then the most powerful nation in the world, Spain. And their motto was, "It is not necessary to hope in order to persevere." Now, going forward, get rid of the people that have caused the problems. That's a pretty straightforward thing, as well. Why would we keep CEOs and CFOs and other senior officers, that caused the problems? That's facially nuts. That's our current system. So stop that current system. We're hiding the losses, instead of trying to find out the real losses. Stop that, because you need good information to make good decisions, right? Follow what works instead of what's failed. Start appointing people who have records of success, instead of records of failure. That would be another nice place to start. There are lots of things we can do. Even today, as late as it is. Even though they've had a terrible start to the administration. They could change, and they could change within weeks. And by the way, the folks who are the better regulators, they paid their taxes. So, you can get them through the vetting process a lot quicker.

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