

**Keating Economics: John McCain and the Making of a Financial Crisis**  
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WILLIAM BLACK

If you think about what fraud is, fraud is the creation of trust and then its betrayal. And that means there's no acid more effective at destroying trust than fraud.

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HOWELL HEFLIN

Do you solemnly swear that the testimony that you will give in this hearing will be the truth, the whole truth, nothing but the truth, so help you God?

JOHN McCAIN

I do.

HOWELL HEFLIN

Many of our fellow citizens apparently believed that your services were bought by Charles Keating, that you were bribed, that you sold your office, that you traded your honor and good names for contributions and other benefits. Many of these same people also apparently believe that your actions, and perhaps the actions of other Senators and Congressmen, was solely responsible for the savings and loan failures of scandalous proportions.

WILLIAM BLACK

Lincoln Savings was the worst, of what we call in criminality, "control fraud," in the nation. That means a fraud run by the people who control the organization. In this case Charles Keating was looting the Savings and Loan. Keating was a not very effective real estate developer who was brought in to acquire Lincoln Savings and Loan by Michael Milken. Charles Keating was and is a very nasty, fraudulent guy. His reputation was quote, "for buying and selling politicians," unquote. One of the people on this list was then Representative McCain.

ROBERT BENNETT (off camera)

Of the Five Senators here before you Senator McCain had the closest personal friendship with Charles Keating.

WILLIAM BLACK

They were confidants, they were mutual political supporters, of course the money flowed one direction from Charles Keating to then Rep. and eventually Senator McCain.

JOHN DOWD

Over three campaigns, including his 1986 Senate campaign, John McCain received roughly \$112,000 from Mr. Keating, ACC employees, and their families.

WILLIAM BLACK

He was someone that McCain took much of his policy advice from on how you should regulate—or in this case not regulate Savings and Loans.

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ROBERT BENNETT

Senator McCain also was the only one who received personal as well as political benefits from Charles Keating.

WILLIAM BLACK

The unique aspect of this relationship between Senator McCain and Charles Keating extended to the family. They're personal friends, Keating flies him down multiple times to the Bahamas and Keating's expense. Keating doesn't simply fly Senator McCain, he flies down McCain's wife as well, and the kids and this one I really like, the babysitter, so that you can make it a real vacation.

ROBERT BENNETT

In nineteen hundred and eighty four and eighty five, then Congressman McCain wrote several letters to Chairman Gray and White House officials urging them to postpone promulgation of the direct investment rule. Then Congressman McCain also supported a resolution to delay the rule. There is evidence that Senator McCain did so at the urging of Mr. Keating or other representatives of Lincoln.

WILLIAM BLACK

Regulators had discovered that Keating had engaged in a massive violation of a key rule called the Direct Investment Rule. And this rule restricted how much Savings and Loans could own in the way of real estate as opposed to making loans on it. The key to this rule was that direct investments were an ideal way to engage in accounting fraud. And accounting fraud is the weapon of choice of these kinds of corporate frauds. Keating had violated the Direct Investment Rule by over six hundred and fifteen million dollars. The largest violation in the history of the agency. And savings and loans that did significant amounts of direct investment always failed and failed catastrophically.

ROBERT BENNETT

I'm identifying for you what this case is that we are talking about. One: Several Senators met with regulators about a pending enforcement matter involving a single company which had sued the bank board in the federal courts.

WILLIAM BLACK

Keating has set up the meeting by recruiting five U.S. senators and of course all five of the senators received major political contributions from Charles Keating. The purpose of the meeting, from Keating's standpoint, is very clear because he puts it in writing. He wants us not to take any enforcement action against this violation, the direct investment rule. Effectively he wants to immunize the worst violation in our history in an institution...

ROBERT BENNETT

Two: The Senators did not have aides present and more importantly, the chief regulator, Chairman Gray, was specifically directed not to bring aides with him.

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WILLIAM BLACK

This meeting was set up for deniability. And the idea was to have five US Senators there and only one regulator there, so there'd be the word of five US Senators against one the regulator with no aides to back him up.

ROBERT BENNETT

Three: Mr. Keating on whose behalf the meeting was held was a major political contributor to each of the Senators who attended the meeting.

WILLIAM BLACK

And that leads to the meeting precisely one week later with four of us from the Federal Home Loan Bank of San Francisco and all five U.S. Senators.

WILLIAM BLACK

It was perceived as enormous pressure and designed to intimidate because that's exactly how Charles Keating set it up.

ROBERT BENNETT

Four: The regulators were asked to withdraw a duly promulgated regulation at the request of a single company and were told that the company would do certain things in return.

WILLIAM BLACK

We are analogous to the police. Can you imagine someone coming to the police and saying well you caught these guys red-handed and they've committed this enormous crime, the biggest in your history, and you know that this kind of crime always leads to terrible, terrible harm to the public but we don't want you to do anything because he's a big political contributor to us so you shouldn't take any action. So we didn't think they would have the nerve to try and do it again when there were actually witnesses. And in particular we didn't think they'd have the nerve because one of my jobs at the meeting was to take notes. And they do the same thing at the start of the meeting. Senator DeConcini says we want you not to take enforcement action against this institution. And Senator DeConcini does it speaking on behalf of the group he is hosting. And Senator McCain says nothing to distinguish himself, or to say no, you know, that's not proper.

WILLIAM BLACK

Skip forward in time. After more direct political pressure setup by the Keating Five the bank board stops all action, to even find the facts against Lincoln savings, even though it knows it is a criminal enterprise. Keating is allowed to stay open for an additional two years which allows them to cause these massive losses of 3.4 billion dollars.

It produced the most expensive failure in U.S. history of a depository institution. Senator McCain knew the facts, because we had briefed him, he knew this was a criminal enterprise, he knew that what was being done was improper, he knew how much undue political pressure, his words, or at least his words originally, was being brought to bear, he was uniquely in the position where he could of protested this and stopped it and stopped this loss, but he did nothing. And his statement is "once I figured out that

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Keating was not being abused I no longer had any need to protect my constituent”, but all the tax payers in America were his constituents. We all ended up paying that 3.4 billion dollars, we just never got it.

“Senator McCain exercised poor judgment in intervening with regulators”

WILLIAM BLACK

Lots of people had drunk the Kool-Aid about deregulation in that era. Now, the savings and loan debacle taught a whole lot of people that was an error, but it didn't teach that to Senator McCain. Instead, he instinctively goes towards greater deregulation.

JOHN MCCAIN

While I was traveling overseas, our financial markets experienced another, unfortunately, another round of upheaval.

WILLIAM BLACK

His reaction to the subprime crisis that we're going through now, which is unquestionably a product of deregulation, was to recommend in his first speech that we should have further deregulation.

JOHN MCCAIN

Our financial market approach should include encouraging increased capital and financial institutions by removing regulatory, accounting, and tax impediments to raising capital.

WILLIAM BLACK

He's said that he doesn't know much about economics. So his key adviser on economics is Phil Gramm. Phil Gramm is more responsible than anyone in Washington in terms of pushing deregulation and non-regulation and to make fun of the victims.

PHIL GRAMM

You've heard of the mental depression? This is a mental recession. You just hear this constant whining, complaining. We've sort of become a nation of whiners.

WILLIAM BLACK

He's picked the worst possible source of advice. If you cant even get the Charles Keating to the world right, you just don't have that judgment factor in terms of your key advisors.

WILLIAM BLACK

If you look at why Lehman and Bear Stearns and Merrill Lynch and AIG and Fannie and Freddie are all in crisis, is because all of them played games on the accounting because you set-up perverse systems that allow people to lie and that comes back to why you need regulators. Senator McCain has not learned the lessons and has continued to follow policies that are going to produce a disaster. If you create that kind of environment you'll get the same thing that you had in the savings and loan crisis except that now we are so

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globalized that the bubbles will be much bigger and you will cause a financial crisis not just in the United States but in many parts of the world. I'm sick of that, I'd like to change that, so that's my motivation.