

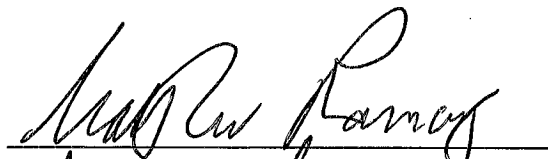
Full Disclosure:
The Pecora Commission and the Political Fight for Financial Reform

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On the basis of this thesis defended by the candidate on 4/26/12
we, the undersigned, recommend that the candidate be awarded highest honors
in Economics and History.



Director of Honors



Faculty Adviser



Third Reader

To my parents,
With love

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Introduction: A Question of Fairness

“All money is a matter of belief.”
-Adam Smith

In the history of the United States, certain dates need no introduction. September 11th, December 7th, and July 4th all remain seared into the national consciousness, days in the country’s history whose importance remains self-evident. To most Americans, adding October 24th to that list would seem both inappropriate and confusing. How could any event compare in significance to Pearl Harbor or the birth of America? The answer lies in what Thomas Carlyle termed the dismal science—economics.

October 24th is a date economists recognize instantly, along with its more colloquial name, Black Thursday. October 24th, 1929 marked the beginning of the Great Crash, the stock market plunge that would eventually bring about the greatest financial crisis in American history. Overnight, the Roaring 20’s crashed to a halt and a new era of deprivation and poverty spread across the United States. The ensuing mayhem that enveloped Wall Street in the days and months following October 24th, 1929 metastasized to such a point that, by 1932, it had become an existential crisis, challenging the basic assumptions that had powered the American economy to unprecedented heights in the heady days of the 1920’s. Americans were faced with the possibility that free-market capitalism’s capacity for destruction outweighed its potential benefits, resulting in not only a demand for a legislative response to the excesses of Wall Street, but also a fundamental challenge to the nature of American commerce.

This thesis does not seek to explore the reasons why the Great Crash occurred or the ways in which the country’s leaders grappled with the different economic

prescriptions to solve the problems afflicting the country. This is not an argument for Keynesian economics over classical economies, or vice versa. Instead, the goal is to examine how the federal government went about investigating those at the epicenter of the Crash and the impact of that investigation on the relationship between the government and private citizens. Probing the investigatory response to both the Great Crash and the larger Depression afflicting America in the early 1930's opens a window into the collective psyche of the United States, allowing historical observers to witness how the country's leaders responded to problems that threatened to derail the birth of the American century. The debates that arose over the role of government in business and the purpose of regulation in a capitalist society were proxies for more difficult questions concerning the relationship between private citizens and government. Was an activist government a positive force in society? Could private citizens be trusted to choose long-term prosperity over short-term profits?

That such debates were occurring across the country in the early part of the 1930's was a stunning reversal from the Roaring 20's, when the efficacy of capitalism was clear to the leaders of America. The development of a Republican Consensus in Washington following World War I was a triumph for private business, as Presidents such as Calvin Coolidge and Warren Harding oversaw a new era of prosperity from afar. Watching as bankers and industrialists helped push America into the 20th century, the federal government remained aloof from the private sector, trusting America's businessmen to harness the potential capacity of the country's resources and workers. For a brief window during the 1920's, it seemed as if the hands-off approach of the nation's chief executives was behind the startling growth in America's economic output.

Bankers, in particular, benefitted from the laissez-faire approach of the federal government, as financial institutions proliferated across the country and American wealth became increasingly tied to financial markets.¹ The explosion of financial markets forced bankers to find new ways of managing capital, leading to the creation of increasingly exotic and complex investment vehicles. The world of finance ceased to be the domain of just Wall Street and became an integral part of Main Street, as Americans rushed to join the stock market boom and enjoy the easy profits that steadily accumulated in bank accounts during the 1920's.²

In reality, the stock market boom of the 1920's was similar to other economic bubbles, built on borrowed money and a sense that the old rules of economics no longer applied. As a banker at National City Bank, then the nation's largest bank and forerunner of Citigroup said, "I thought I was in a new era."³ The wealth destruction that occurred in the aftermath of the 1929 market crash was a consequence of a new era, one in which finance played a much larger role in the American economy than ever before. While bankers managed previous financial crises privately, the growth of the financial industry during the 1920's made the effects of a stock market crash more widespread and permanent.

The development of financial institutions and their increasing influence over the American economy was part of a larger change in American society, a change reflective of the differences between the 19th and 20th centuries. As Americans moved into cities

¹ Steve Fraser, *Every Man a Speculator: a History of Wall Street in American Life*, New York, NY: HarperCollins, 2005, 415.

² Fraser, *Every Man a Speculator: a History of Wall Street in American Life*, 415.

³ *Hearings before the Committee on Banking and Currency Pursuant to S.Res. 84 and S.Res. 56 and S.Res. 97. : 1932 - 1934 (1934)*, 2115.

and immigrants reached the ports of the East Coast, the agrarian nature of America melted away in favor of an urbanized economy that bore little resemblance to the nation of farmers envisioned by Thomas Jefferson. The combination of aggressive bankers and an uninvolved government allowed financial institutions to permeate every aspect of the American economy, ranging from personal savings accounts to the bond offerings of major corporations. That one industry was able to become so ubiquitous without attracting the attention of the government speaks to America's relationship with free-market capitalism and its influence over the leaders of this country.

While governmental involvement in the banking sector stretches back to America's beginnings, the lack of a regulatory body with the power to enforce financial laws meant that banks were free to pursue whatever strategies were most profitable up until the Great Crash. Laws such as the National Banking Act of 1863 and the Federal Reserve Act of 1913 dealt with the structure of the financial sector, placing little emphasis on regulating the investment activities of financial institutions. Furthermore, financiers were heavily involved in the development of banking legislation, creating a system built by the very people it was supposed to control.

It was not until America found itself in the depths of the Great Depression that the financial industry was finally called upon to answer for the widespread destruction of wealth that occurred when the stock market crashed in October 1929. Even then, President Herbert Hoover remained cautious in his attempt to uncover the reasons behind the Great Crash, calling for nothing more than an investigation into short selling. Only after the November 1932 election of Franklin Roosevelt did the investigation of Wall Street gain momentum and begin to uncover answers to questions concerning the

secretive nature of the financial community. The investigation eventually became known as the Pecora Commission, authorized by the Senate Committee on Banking and Currency and led by Ferdinand Pecora. The Commission was created to respond to the decimation of the special relationship between America and free-market capitalism caused by the stock market crash of 1929.

The Commission's investigation raised questions about the nature of capitalism, the role of regulation, and the relationship between the government and private citizens. The Commission's leader, Ferdinand Pecora, encapsulated many of the intense changes occurring in America during the first half of the 20th century, making the investigation a showcase for the ever-evolving definition of what it meant to be an American. Pecora and his investigation forced Americans to confront the societal and economic changes caused by the financialization of the American economy and its implications for free-market capitalism.

That the American response to the greatest financial catastrophe in its history was simply a Congressional investigation demonstrates the level of commitment to capitalism that existed in the United States during the Great Depression. No mass movement dedicated to overthrowing the financial industry rose up, and the socialist uprisings that occurred in Europe were never a serious threat in America. Why did Americans never seriously, at a governmental level or otherwise, consider revolutionary changes to the economic model that had left over a quarter of the country unemployed? Part of the answer lies in work of bankers to deflect blame for the market crash away from themselves and create a narrative that presented the Great Depression as a historical anomaly, the product of a few bad men ruining a perfectly good system. Ferdinand

Pecora himself described how bankers worked to convince Americans that “a whole group of high-minded men, innocent of social or economic wrongdoing, were expelled from the temple because of the excesses of a few.”⁴

While Pecora felt that bankers were being insincere with this explanation, members of the financial community stood on firm legal ground when they countered that banks broke no laws in the years preceding the Great Crash. Bankers argued that the natural business cycle of boom and bust was more at fault for the Great Crash than anything else, and it wasn't as if bankers were alone in being blindsided by the intensity and longevity of the Great Depression. Bankers demanded that they not be tried in the court of public opinion, where unfair accusations and populist bombast had more influence than facts and figures. Ultimately, the success of the Pecora Commission would be dependent upon the ability of the investigation to prove that the populist rhetoric about the ills of the financial system was grounded in truth.

Yet bankers would never have been able to overcome populist anger at the consequences of the 1929 market crash if Americans had not accepted that capitalism was a system that created winners and losers, and that such a system was preferable to a state-dominated economy. A level playing field, where the winners and losers were decided on a fair basis, was the condition Americans demanded in exchange for accepting the risk of losing inherent in a capitalist society. The work of the Ferdinand Pecora and his Commission became the discovery of the ways in which financial institutions rigged the capitalist system to reward themselves, a charge that put Pecora at odds with the most

⁴ Ferdinand Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, New York: Simon and Schuster, 1939, 10.

powerful financiers in America. If Pecora could prove with hard evidence and demonstrable facts that banks worked to create an inequitable financial system that favored major institutions, he would create the necessary conditions for the introduction of regulation and reform.

Ferdinand Pecora, the central character in this story, was a strange choice to lead the initially Republican-controlled investigation into Wall Street, as he had little background in finance and had been a member of the Democratic Party for most of his adult life. As a resident of New York City since the age of 4, he represented an East Coast point of view that many blamed for bringing about the market crash in the first place. An immigrant from Sicily as a small child, Pecora also embodied the changing face of America, representative of the masses of Southern and Eastern Europeans who came to the United States and were met with suspicion and disdain by the ruling classes (Wall Street and Congress included). Despite these heavy odds against him, Pecora was able to run an investigation powered by his dogged pursuit of the truth and a deeply held desire to use the Commission as a means to bring about changes to a system he regarded as morally corrupt.

Pecora was able to demonstrate the need for the creation of financial regulation through a series of cross-examinations that undercut the legitimacy of the nation's leading financiers and allowed the entire country to see the inner workings of the country's largest banks. Pecora's power of subpoena led to the public testimony of men whose "names were household words, but whose personalities and affairs were frequently shrouded in deep, aristocratic mystery."⁵ By simply revealing to the Senate and the

⁵ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 3.

American people that the men in charge of the biggest financial institutions were human beings, not demi-gods whose understanding of economics and finance was unassailable, Pecora demonstrated that they were both capable of making mistakes and in a position where such mistakes could have serious consequences for the economy as a whole. Pecora convinced America that the pervasive influence of Wall Street was too strong to allow for a policy of self-regulation.

While revealing the human side of the titans of Wall Street may have empowered Pecora to pursue his case for financial regulation, it was the actions he uncovered that made the more dramatic case for regulation of Wall Street. Pecora was able to show that National City Bank knowingly misled its clients in search of ever-larger commissions, and that the Chairman and President of the company, Charles Mitchell, had managed to avoid paying income taxes in 1929 despite receiving a salary of over \$1 million. Pecora went on to show that the self-regulating structures put in place by Richard Whitney, Chairman of the New York Stock Exchange, were ineffective and rarely enforced. Pecora also demonstrated how Albert Wiggin, Chairman and President of Chase National Bank, instructed his lieutenants to organize stock pools that artificially inflated the bank's stock price. The issue of banking structure became a matter of public knowledge, as Pecora revealed that the country's leading financial institutions used legal loopholes to effectively own both commercial and investment banks, a clear violation of the intent of existing banking laws. Together, these revelations combined to prove Pecora's point that the biggest banks in America worked to create a financial system that put the average investor at a severe disadvantage.

Yet, for all his achievements, Pecora's use of personal attacks on the accumulated influence and wealth of Wall Street bankers indicated an over-reliance on populist rhetoric and a failure to understand the inner workings of the country's financial system. Instead of digging deeply into the minutiae of finance, Pecora's investigation sought to chastise the financial community as a whole. Pecora refused to acknowledge the arguments of the bankers whom he questioned, viewing their qualified answers to his complex questions as evidence of the contempt Wall Street had for the rest of the country. Pecora viewed the financial crisis through a political lens, and sought to identify political solutions to the problems of Wall Street. Unfortunately, both the financial industry and the country itself would have been better served by an investigation conducted above the messy plain of electoral politics, an investigation focused on encouraging good policy; not good politics.

Ultimately, Pecora's investigation was too clouded by political agendas to serve as an honest reckoning of the Great Crash. By focusing on issues of salary and tax returns, Pecora made a conscious decision to appeal to the basest elements of American populism. Through the lens of Pecora's investigation, all Wall Street financiers were taking advantage of a rigged system to fleece honest investors. That such a suggestion was taken seriously indicates both the degree of destruction caused by the Great Crash and the ability of Pecora to simplify complex issues through the usage of populist language.

Pecora's success in demonstrating the structural problems of the American financial system, combined with his willingness to use any means necessary to achieve that success, makes placing him within one ideological category difficult. Was Pecora the

quintessential New Dealer, arriving just in time to ensure “the replenishment of democracy, the rescuing of the federal government from the clutches of big business, and the significant redistribution of political power?”⁶ According to historian Barton Bernstein, this interpretation of the New Deal, popular with liberal historians in the years after the Great Depression, argues that Pecora was part of a larger movement to bring sanity to the political and economic structures of America. Pecora, who began his career in politics by supporting Theodore Roosevelt’s third party, Progressive candidacy for President in 1912, would seemingly agree with labeling the Commission that bore his name as a liberal attempt at readjusting the field of finance to create a fairer, more transparent system.

However, the aggressive tactics used by Pecora to illustrate the intense problems on Wall Street could be indicative of a more radical approach that was lost within the grand sweep of the larger New Deal. Was Pecora independent of, in the words of Richard Hofstadter, “the chaos of experimentation” that defined the New Deal?⁷ Could it be that Pecora was driven by a Progressive impulse that was to the left of Franklin Roosevelt’s more conservative economic program? Both Barton Bernstein and Alan Brinkley argue that the New Deal was a fundamentally conservative movement, one that was “profoundly conservative and continuous with the 1920’s⁸” and “reconciled to the existing structure of the economy.”⁹ Pecora’s willingness to challenge the arguments and

⁶ Barton J. Bernstein, *Towards a New Past; Dissenting Essays in American History*, New York: Pantheon, 1968, 264.

⁷ Richard Hofstadter, *The Age of Reform: From Bryan to F.D.R.*, New York: Knopf, 1955, 307.

⁸ Bernstein, *Towards a New Past; Dissenting Essays in American History*, 6.

⁹ Alan Brinkley, *The End of Reform: New Deal Liberalism in Recession and War*, New York: Alfred A. Knopf, 1995, 6.

assumptions of financiers throughout his investigation indicates that he did not accept the existing power structure in the ways other New Dealers might have, making it possible that the Pecora Commission needs to be viewed as ideologically distinct from the New Deal.

Finally, do the conservative critiques of the New Deal provide the best context through which to understand the Pecora Commission? While organizations such as the American Liberty League appeared like shooting stars over the American political landscape during the 1930's, voraciously and briefly decrying the New Deal as the triumph of a monstrous combination of socialism and fascism in America, more serious critiques did emerge which questioned the ways in which investigations like Pecora's were changing the relationship between the federal government and private citizens. President Herbert Hoover lamented that the New Deal marked "an attempt to revolutionize the American system of life," seeing the entire program as a departure from the principles of individual liberty that had previously defined this country.¹⁰ David Lawrence, founder of the *U.S. News and World Report*, wrote that the banking laws passed during Pecora's investigation were evidence that "the Federal Government has sought to take charge of credit operations and control and direct... where the money of the American people is deposited."¹¹ Was Pecora an ideological warrior who sought to radically change the role of government in relation to the financial industry? According to some conservative interpretations, this was exactly the case.

¹⁰ Herbert Hoover, *The Memoirs of Herbert Hoover, The Great Depression, 1929-1941*, New York: Macmillan, 1952, 351.

¹¹ David Lawrence, *Stumbling into Socialism and the Future of Our Political Parties*, New York: D. Appleton-Century, 1935, 18.

With such varying interpretations of the motivations behind and ultimate consequences of the New Deal, where can the Pecora Commission be situated within the historical framework that exists concerning the efforts of the federal government to combat the Great Depression? Ultimately, both Pecora and the Commission were too complex to be neatly slotted into a larger understanding of the era. While some of Pecora's questions clearly challenged the underlying assumptions of capitalism, he never argued for the nationalization of the financial industry or even an end to many of the investment strategies that helped precipitate the Great Crash. In some ways, this could arguably make Pecora an example of a conservative in liberal's clothing; a species of pseudo-liberal that historians like Bernstein and Brinkley claim populate the history of the New Deal. This is not the case. Nor is it the case that the Commission was driven by a desire to expropriate the entire financial system from the hands of private citizens. Pecora was a liberal-minded investigator who felt that the financial system was not fundamentally wrong, but structurally in need of improvement. The Commission, by addressing problems of transparency and enforcement in the financial industry, sought to identify ways that would enable financial institutions to successfully play their part as vital, important segments of the national economy. This thesis seeks to understand whether the Commission was successful in achieving this goal.

The Pecora Commission remains significant to this day because it marked the first time the government of the United States attempted to energetically involve itself in the regulation of the financial industry. Ferdinand Pecora was able to construct a case that delegitimized many of the leaders of the financial world while also illustrating the intense need for a regulatory body on Wall Street. However, he achieved his goals by relying on

the sort of political language that deters from the development of sound governmental policy. Did Pecora's ends justify his means? Understanding the ways in which political considerations shaped and influenced the findings of the Pecora Commission is the primary goal of the thesis.

Chapter 1: Finding the Right Man

"The country is not in good condition."

-Calvin Coolidge, January 1931

Hoover's Dilemma

Herbert Hoover was running out of options. While his Presidency began during a time of unprecedented prosperity for the American people, the market crash of 1929 had plunged the American economy into a depression that had deepened with each year of Hoover's term. All that was left of the Roaring 20's by February 1932 was a grey-green fog that seemed to perpetually hang over Hoover's White House, the last remnant of the wealth that had evaporated into thin air over the course of his term. Faced with protestors marching on Washington and the proliferation of Hooverville shantytowns across the country, the President wanted to channel the country's anger towards the people he felt were most responsible for the market crash—short sellers.

Short sellers were investors who bet that a stock price would fall instead of rise, and the downward pressure they encouraged in stock exchanges exacerbated economic uncertainty. Short selling was just one example of the increasingly complex investment strategies developed by the financial sector in the years leading up to the Great Crash, part of a wave of financial engineering that redefined securities markets. Powered by a rejuvenated global economy following the end of World War I and a public more comfortable with securities markets due to Liberty Bond sales during World War I, American financiers spent the 1920's exposing an ever-increasing number of people to the world of finance.¹² Success followed success until October 1929, when the entire

¹² Emily S. Rosenberg, *Financial Missionaries to the World: the Politics and Culture of Dollar Diplomacy, 1900-1930*, Durham N.C.: Duke UP, 2003, 240.

edifice came crashing down over the course of a few weeks. Completely caught off guard, Wall Street was decimated by plunging stock values and bond defaults.

Identifying the reasons behind such an astonishing reversal of fortune was difficult enough, but for politicians whose re-election hopes depended on popular support, finding a scapegoat for Great Crash was of equal importance. Herbert Hoover maintained that short sellers were the cause behind the market crash of 1929, and told the American people that if these investors had a sense of patriotism they would “close up these transactions and desist from their manipulations.”¹³ Unfortunately for Hoover, his stern scolding had done little to prevent short selling or catalyze economic growth.

Restricted by his beliefs in the separation of commerce and government, Hoover moved forward with what he envisioned to be the best way to prove to Americans the detrimental impact of short selling. Hoover did not grasp the new developments in public finance that would eventually become known as Keynesian economics, and he was limited by his reliance on traditional economic thinking concerning financial crises. Hoover failed to understand that the changing nature of the financial industry meant old responses to new problems were destined to fail. Instead of calling for creative solutions to a Depression that seemed to deepen with each day of his Presidency, Hoover fell back on an old political tactic. He called for a Congressional investigation.

The Investigation Begins

Hoover’s decision to call on the Senate to investigate short selling came in February of 1932, the year in which the Great Depression’s hold on the American economy seemed permanent. Unemployment reached nearly 24% nationwide, and the

¹³ Herbert Hoover, "Press Conference Statement," Speech, Washington, D.C, 10 June 1931, *The Depression Paper of Herbert Hoover*.

Dow Jones Industrial Average had plummeted from a peak of 381 in 1929 to 41 by the time Hoover decided that an investigation into the market crash was in order.¹⁴ The timing of Hoover's decision was influenced by the upcoming Presidential election, which loomed only eight months away. Hoover's biggest problem concerning his re-election was the frustrating staying power of the Great Depression, which was not only unprecedented in its length but also in its level of economic destruction. From October 1929 through 1932, nothing Hoover did made an impact on the economic situation. Ultimately, it wasn't so much the past problems that occurred on his watch that haunted Hoover's Presidency as much as the total lack of hope in things improving by Election Day in November 1932. Unless he was able to retake control of the American economy or convincingly push the blame for the Depression onto someone else, Hoover was at risk of becoming a one-term President.

Hoover's focus on short sellers was driven by a belief that, on a fundamental level, the American economy retained the same core strength that had been so apparent only a few years before. By pointing the finger at short sellers, Hoover was able to blame a small group of faceless financiers for the immense economic destruction that had followed the market crash. Hoover refused to consider that the country's economic problems ran deeper and sanction a larger investigation into Wall Street's role in causing the Great Depression. In essence, Hoover believed that short sellers were the problem with the American economy, not a symptom of larger structural issues caused by the growth of the financial sector during the 1920's.

¹⁴ Steve Fraser, *Every Man a Speculator: a History of Wall Street in American Life*, New York, NY: HarperCollins, 2005, 415.

Hoover's patriotic appeal against short selling not only sought to identify a scapegoat for the Depression, but also played into the narrative being pushed by the biggest banks on Wall Street. As long as Americans blamed short sellers for the Depression, the titans of Wall Street could maintain that they were prevented from saving the American economy by the machinations of others. The American Bankers Association, a group representing Wall Street banks, claimed that Wall Street "conformed conscientiously to principles of sound public service," making the country's biggest financial institutions the "true strength of American banking."¹⁵

Hoover's decision to not attach blame to Wall Street was partly driven by a decade long relationship which existed between big business and the Executive Mansion, beginning with cronyism of Warren Harding and reaching a peak during the administration of Calvin Coolidge. Hoover, who served as Commerce Secretary for both men, was the third consecutive Republican to ride a wave of economic growth and prosperity to victory when he was elected President in 1928. Calvin Coolidge summed up the underlying theme of each man's economic and business policy when he proclaimed, "The chief business of the American people is business."¹⁶

The Republican consensus that emerged during the 1920's was a laissez-faire approach to governing that focused on lowering taxes and allowing businesses greater freedom to pursue their own self-interests. Over the course of the 1920's, the highest income tax rate dropped from 77% to 25%, dividends paid in stock ceased to be counted

¹⁵ Francis Sisson, "Men, Not Laws, Make Sound Banks," *Nation's Business* 21.1 (1933): 13.

¹⁶ Calvin Coolidge, "Address to the Society of American Newspaper Editors," Washington D.C., 25 Jan. 1925, Speech.

as taxable income, and government spending dropped considerably.¹⁷ The Republican administrations of the 1920's oversaw a sea change in the levels of taxation faced by individuals, but the economic growth of the United States more than made up for the lost revenue. Corporate America reaped the benefits of an uninvolved government as well, with only one corporate merger out of 1,268 being blocked by government regulators during the 1921-1929 term of Treasury Secretary Andrew Mellon.¹⁸

The lack of any serious economic or financial crisis in 1920's America contributed to the notion that a policy of self-regulation was sufficient to keep the potential excesses of Wall Street under control. Bankers insisted that the system in place allowed the people with the most experience in and knowledge of finance to set the rules. The introduction of curious governmental regulators would only increase the complexity of the issues at hand by adding a political calculus to the enforcement of regulatory policy. The close relationship between business leaders and the Republican White House ensured that distaste for governmental regulation was shared in the corridors of power in Washington, D.C. and New York City. As long as businesses proved themselves capable of self-regulation, such a policy worked well. The Great Crash and Depression that followed October 1929 called into serious question whether one of the fundamental tenets of Republican policy in the 1920's retained its intellectual foundation.

Hoover was trapped by the Republican consensus he helped build, prevented on ideological grounds from interfering in the private sector to help restart the economy. A decade of prosperity had left Hoover stuck with a governing style that was no longer compatible with economic realities. The most telling example of Hoover's inability to

¹⁷ Fraser, *Every Man a Speculator: a History of Wall Street in American Life*, 379.

¹⁸ Fraser, *Every Man a Speculator: a History of Wall Street in American Life*, 380.

address the Depression was his refusal to ban short selling¹⁹, a decision that signaled to investors that, no matter his heated rhetoric, Herbert Hoover was not a man capable of challenging Wall Street on its home turf.

Instead, Hoover decided to get in contact with Frederic Walcott, a Republican senator from Connecticut and one of the President's few remaining allies. Walcott also had close relationships with the bankers of Wall Street, a conflict of interest that did not seem to concern either man as they formulated a plan to investigate short selling through the Senate. Hoover's choice of Walcott reflected a reality that became apparent as soon as the investigation came together; Wall Street was essentially ungovernable as long as Hoover was the President. He was too much a creature of the 1920's, unable and unwilling to realize that the economic and political rules that governed his ascent through the Republican Party ranks no longer applied.

Walcott announced the formation of an investigation into the actions of short sellers at a press conference in late February 1932, telling reporters that the investigation would uncover the people "who have deliberately taken the bloom off of every constructive enterprise²⁰" in the country. As Walcott's words indicated, the investigation was meant to be limited to short selling, reinforcing the Hoover administration's belief that Wall Street's business model was not problematic on a deeper level. Walcott's words marked the beginning of the first attempt by the federal government to publicly investigate the Great Crash, but the narrow focus of the investigation did not bode well

¹⁹ Herbert Hoover, *The Memoirs of Herbert Hoover: The Cabinet and the Presidency, 1920-1933*, New York: Macmillan, 1952, 16-17.

²⁰ Michael A. Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, New York: Penguin, 2010, 18.

for those hoping for a true reckoning of the greatest financial disaster in United States history.

Sons of the Wild Jackass

Despite Hoover's best efforts to make Senator Walcott the leader of the Senate investigation, the chairman of the Senate Committee on Banking and Currency had other ideas. Chairman Peter Norbeck, Republican senator from South Dakota, had minimal experience with finance and liked it that way.²¹ As a member of a group of congressmen known as the Sons of the Wild Jackass, Norbeck and his fellow lawmakers represented a Midwestern point of view that was largely distrustful of Washington and Wall Street.²² Marginalized by three consecutive presidents who had no use for his populist beliefs, Norbeck viewed an investigation into Wall Street as a chance to finally make his mark in Washington. He could also use the publicity that a public inquisition of Wall Street would surely generate, as Norbeck knew that the 1932 elections were not going to be a triumph for the Republican Party.

That Norbeck was still a Republican at all in 1932 was more a reflection of the strength of the two party system than any ideological similarities between Norbeck and the majority of his fellow Republican senators. Along with men like George Norris and Robert La Follette, Norbeck remained a member of the Republican Party in part because it gave him access to high-ranking positions on Senate committees.²³ The success of Harding, Coolidge, and, for a few months, Hoover in overseeing the economic boom of

²¹ Herbert Schell, *History of South Dakota*, Lincoln: University of Nebraska, 1961, 278-281.

²² Fraser, *Every Man a Speculator: a History of Wall Street in American Life*, 381.

²³ Ray Tucker, "Those Sons of Wild Jackasses," *The North American Review* 229.2 (1930): 225-33.

the 1920's had left the Sons of the Wild Jackass objects of derision on Capitol Hill, men who pined for the long-lost Progressivism of Theodore Roosevelt. The triumph of the pro-business, anti-regulation wing of the Republican Party during the 1920's made Peter Norbeck and his fellow Midwesterners relics of a bygone age when big business was viewed with suspicion and social justice was a pillar of the Republican Party platform.

Populism, Progressivism, and the Birth of a New America

Senator Norbeck's background as a Midwestern Republican in the age of Theodore Roosevelt placed him squarely at the nexus of two movements that shaped and influenced the direction of American politics from Reconstruction to the rise of the Republican Consensus in the 1920's. Populism, birthed on the rolling plains of the American heartland, was a powerful, visceral reaction to the changes wrought by industrialization and urbanization in the second half of the 19th century. Largely agrarian in both spirit and composition, Populism was a movement defined by its focus on the past. According to historian Richard Hofstadter, Populism was defined by the belief that "the health of the state was proportionate to the degree which it was dominated by the agricultural class."²⁴ Clearly at odds with the growth of cities that accompanied the diffusion of industrial activity throughout America, Populists promoted the idea that America was turning its back on the founding principles of the Republic by embracing the changes caused by industrialization.

Despite its unrealistic calls for a return to a rural age in America, Populism did manage to create a critique that resonated throughout a significant portion of the electorate. Populism was the first American political movement to point to the

²⁴ Richard Hofstadter, *The Age of Reform: From Bryan to F.D.R.*, New York: Knopf, 1955, 62.

fundamental inequities created by the Industrial Revolution and demand a response from both federal and state governments. William Jennings Bryan, the standard bearer of the Populist movement and its most successful politician, framed the populist message in such a way as to include as many people as possible, telling his followers that the nation was split in two, divided between “on the one side...moneyed interests, imperious, arrogant, compassionless...on the other side an unnumbered throng.”²⁵

Populism was able to capture the imagination of rural America because it gave voice to the frustrations of people who believed they were watching America transform into a something very different from the country they had been born into. The greatest signifier of this change was the growth of financial interests based on the East Coast, the money power in the language of Populism. Populist politicians effectively used the money power as the ultimate rhetorical boogeyman, faceless, nameless, and therefore all the more terrifying. The destruction of the moneyed interests and the return to an agrarian-dominated America marked the ultimate goal of the Populist movement, one that was equally bold and unfeasible.

The issue that epitomized the struggle between Populists and the urban centers of America was that of free silver, which would come to define the Populist movement as well as bring about its fall from prominence.²⁶ The free silver movement called for a more inflationary monetary system (in comparison to a monetary system based on the gold standard) that would allow debtors to more easily make payments to the institutions to which they owed money. In practice, free silver would create a system that benefitted agrarian farmers at the expense of financial institutions. William Jennings Bryan was the

²⁵ Hofstadter, *The Age of Reform: From Bryan to F.D.R.*, 65.

²⁶ Hofstadter, *The Age of Reform: From Bryan to F.D.R.*, 104.

Democratic candidate for President in both 1896 and 1900, each time running with free silver as one of the pillars of his campaign. Each time he was defeated, with his 1900 defeat marking the end of Populism as a major force in American political life. Although Bryan was ultimately unsuccessful in his bid for national office, he and his fellow Populists ensured that the Americans would forever be mindful of the growing power of financial and industrial interests in America.

Despite its relatively brief stay on the national stage, Populism remained influential because its original success, identifying and demanding a response to the changes wrought by urbanization and industrialization, would be repackaged and spread to even larger segment of people by the next influential political force to emerge in America—Progressivism. Progressivism, much like its intellectual cousin Populism, sought to address the problems that arose in the era when “the great corporation and the corrupt machine” began to exert undue influence on America.²⁷

Unlike the largely rural and sectional Populist movement, Progressivism managed to be “urban, middle-class, and nationwide,” a more accessible political movement to the ever-swelling number of Americans located in urban economic centers. The Progressive movement can be traced back to the initial attempts of Congress to address the growing influence of big business, in particular the passage of the Interstate Commerce Act of 1887 and the Sherman Act of 1890, each of which attempted to curb the pervasiveness of monopolistic tendencies in American commerce.²⁸ From the beginning, Progressivism was a more refined version of Populism, aiming to address the problems of urbanization and industrialization by returning political power to the individual.

²⁷ Hofstadter, *The Age of Reform: From Bryan to F.D.R.*, 5.

²⁸ Hofstadter, *The Age of Reform: From Bryan to F.D.R.*, 164.

Yet, in many ways, Progressivism suffered from the same backward-looking syndrome as Populism. The fundamental conservatism that defined both movements is strange looking back from the modern era, when change is largely associated with a liberal desire to address society's problems. Even its name, Progressivism, indicates an aspiration of advancement, not regression. Despite that, Progressives felt they were working towards the restoration of economic individualism and political freedom by fighting the hydra-headed enemy of big business and political corruption. To Progressives, these were the problems that needed to be solved if America was again to be a land where each man's vote counted and success in business was a product of hard work and moral virtue.

Although the rise of intricate trusts and monopolies during the second half of the 19th century demanded some response, Progressivism's attempts to address the rise of big business was complicated by a need to walk a fine line between necessary regulation and governmental overreach. Progressives, unlike their Populist predecessors, were not distrustful of modern industry in general; in fact, the spread of industrialization to cities had increased the prosperity of the urban middle-class. Instead, Progressives "were haunted by the specter of a private power far greater than the public power of the state."²⁹ The dilemma facing Progressives, as the movement crested in the first decade of the 20th century, was how to identify the appropriate way to combat the dominance of a few big monopolies without damaging the overall economic health of the United States. The central paradox at the heart of the Progressive movement was that to address the power of the trust companies more authority must be vested in the federal government, further

²⁹ Hofstadter, *The Age of Reform: From Bryan to F.D.R.*, 229.

moving the country away from the decentralized, individualistic system that Progressives claimed to cherish.

The inability of the Progressive movement to sufficiently reconcile its goals with its own internal contradictions prevented it from passing the kind of reforms that could have seriously impacted the way industries like the financial sector did business. Following the Panic of 1907, when a liquidity crisis forced J.P. Morgan to use his own fortune to prevent an even more widespread banking panic, Progressives in Congress realized that financial reform was necessary to address the growing influence of the financial community. Over the next decade, Congress investigated “the money trust” to determine if a cabal of bankers controlled the entire financial sector, ultimately finding that J.P. Morgan and his fellow investment bankers exercised an undue influence over corporate America. Yet the passage of the Federal Reserve Act of 1913, which established the country’s central bank and sought to give the federal government a means to address future financial panics, was largely crafted in close consultation with the very bankers whom the Act originally meant to unseat from power.³⁰ The Progressive fear of damaging the economic performance of the country prevented the movement from taking the regulation of Wall Street out of the hands of Wall Street itself.

The failure of the Progressive movement to address some of the problems festering on Wall Street was indicative of a larger decline in political influence, as the conclusion of Woodrow Wilson’s Presidency in 1920 brought an end to the movement’s explicit sway over national politics. In particular, the Republican Party (once home to Theodore Roosevelt, the first Progressive President) moved away from Progressive ideals

³⁰ Robert H. Wiebe, *The Search for Order 1877-1920*, New York: Hill and Wang, 1987, 211.

and began to embrace a style of laissez-faire capitalism that would have been unthinkable in the first decade of the 20th century. It seemed as if Republicans, encouraged by an electoral mandate from the country, felt that the growing pains of industrialization were largely over and suspicion of big business was no longer necessary.

The fall of the progressive wing of the Republican Party was matched by the rise of Wall Street's influence on Washington, and the massive tax cuts that benefitted corporations and the richest strata of America were a reflection of Progressivism's waning influence on Congress. For Senator Peter Norbeck, the growing role of finance in American life was part of a larger change in the nature of America. The agrarian nation he had been born into was rapidly becoming one of urban centers, flooded with immigrants from countries in Southern and Eastern Europe. New York City, teeming with immigrants and home to Wall Street, represented everything that Norbeck felt was going wrong with America. The long-held dream of both Populists and Progressives to return America to an earlier time of rugged economic individualism seemed forever dead.

Truthfully, the focus of America was no longer on the heartland, the prairies and plains that had formed the backbone of Norbeck's America. His belief in Progressivism was real, formed by his experiences growing up on a farm in South Dakota and the difficulties faced by rural folk struggling to make ends meet each year.³¹ Norbeck had no use for securities trading or the international bond market, and his refusal to acquire a familiarity with Wall Street had left him adrift in the Washington of Harding, Coolidge, and Hoover. The Senate investigation, announced only eight months before he was likely to lose the chairmanship of the Senate Committee on Banking and Currency and the last

³¹ Schell, *History of South Dakota*, 278-281.

vestiges of his influence, was a godsend to Peter Norbeck. Finally, he had the opportunity to air his beliefs and challenge the titans of Wall Street. President Hoover might have entrusted Senator Walcott to form the investigation, but Norbeck was still the chairman of the committee. He had no intention of ceding an iota of authority to a lackey of Herbert Hoover.

Finding the Right Man

The first challenge before Norbeck and his fellow senators on the Senate committee was to find a qualified investigator to lead the inquiry. Although the opportunity to lead a Senate investigation on an issue that seemed destined to attract the attention of the media would ostensibly interest a number of qualified volunteers, Norbeck was still without an investigator by the end of March 1932. The problems before him were manifold. Most lawyers with the requisite knowledge of finance and Wall Street were too connected to financial institutions to be considered impartial. Furthermore, many lawyers feared an end to their private practices if they challenged Wall Street on such a public stage.³² Another reason was much baser, more reflective of the terrible condition of the American economy. Conservative members on the committee, aligned with Walcott and Hoover, had managed to limit funding for the investigation after Norbeck wrestled control away from Walcott. By limiting any investigator's salary to only \$255 a month, most lawyers could not afford to lead such an investigation, especially one that might put an end to future business.³³

³² Hugo Black, "Inside a Senate Investigation," *Harper's Monthly Magazine* 172 (February 1936): 275-86.

³³ Black, "Inside a Senate Investigation," 275-286.

Claude Branch, a former attorney in Hoover's Justice Department with little background in finance, was selected to be the temporary counsel by Walcott while Norbeck was visiting constituents in South Dakota. Hoover and Walcott were not going to give up control of the committee easily, and the name "C.R. Branch" appeared on the list of Oval Office guests the day Branch was named counsel.³⁴ With Hoover pushing for quick action, the Committee subpoenaed Richard Whitney, Chairman of the New York Stock Exchange.

Richard Whitney epitomized the East Coast elite that Norbeck distrusted, with his imperious bearing and lineage that stretched back to the Pilgrims.³⁵ From his perch at the top of the New York Stock Exchange, he oversaw the country's largest securities market and decided which companies had access to the Stock Exchange. His testimony was the first chance for Norbeck to broaden the investigation from a focus on short sellers to a larger inquiry into Wall Street in general. Norbeck eagerly awaited the occasion, ready to reveal to the entire country the fraudulent actions of Wall Street.

Whitney's Triumph

The Whitney testimony was a disaster for Norbeck. The lack of financial knowledge that Norbeck had worn as a badge of honor was a massive liability, as Whitney smoothly responded to Norbeck's exhortations with ease. Branch's tentative questioning led to his quick dismissal in favor of his deputy, William Gray, but the lack of preparation by all the government officials was readily apparent. Whitney commented

³⁴ *Public Papers of Herbert Hoover*. By Herbert Hoover. U.S. Government Printing Office, 1977. Print

³⁵ Fraser, *Every Man a Speculator: a History of Wall Street in American Life*, 417.

afterwards that, “they were handicapped by their lack of familiarity with the routine of the brokerage business,” leading to “the record containing many inaccurate statements.”³⁶

Norbeck’s zeal for uncovering any shred of evidence against Whitney and his fellow financiers led to one exchange in which Norbeck, desperate for an admission of wrongdoing by Whitney, lamented that the Chairman of the New York Stock Exchange refused to “grant that anything in the market is illegal.”³⁷ The comment demonstrated Norbeck’s complete lack of preparation. Did he expect Whitney to simply admit to wrongdoing on the part of his fellow financiers simply because a senator asked him to? Unable to uncover any actual evidence that Whitney or anyone else at the Stock Exchange had done anything illegal, Norbeck could do nothing but hope a witness would simply admit guilt without first being presented with proof of a crime.

Norbeck’s obvious anti-Wall Street feelings did not help matters, leading the Commission to be dismissed by *The Wall Street Journal* as an “abuse of inquisitorial power” that sought to declare the financial industry guilty until proven innocent.³⁸ While Norbeck’s passionate distaste for Wall Street was a driving force in the Commission broadening its agenda beyond just short selling, the appearance of a witch-hunt prevented the investigation from gaining legitimacy in the eyes of most Americans.

An example of the readily apparent disgust many of the senators had for both Whitney and his fellow financiers was evident in an exchange between Whitney and Senator Smith Brookhart, an Iowan Republican who, along with Peter Norbeck, was one

³⁶ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 52.

³⁷ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 49.

³⁸ *Wall Street Journal* [New York City] 23 Apr. 1932.

of the few remaining Republicans in the Senate who traced their political routes back to the Progressivism of the early 20th century. Brookhart questioned Whitney on the impact of the Great Crash on farmers and the agricultural industry, demanding an explanation of Wall Street's role in the Great Crash that so impacted the interior of America.

Senator Brookhart: Agriculture is about a third of the buying power of the whole country, and that buying power has been reduced and cut down since 1920 and the credit of agriculture almost entirely destroyed, and for that reason agriculture can not buy the necessities of life at this time. It is in a bankrupt condition; nearly 2,000,000 farmers have lost their homes or their life savings, and that does not seem to concern you down in Wall Street at all.

Mr. Whitney: It concerns us vitally, but you are going into details that I say I do not know.

Senator Brookhart: That is what I am complaining about. You ought to know that.

Mr. Whitney: What good would that do?

Senator Brookhart: You talk about better business methods. Are you going to cure this depression with a third of the American people driven down into peasantry or bankruptcy?

Mr. Whitney: You are not accusing me, Senator Brookhart, of being able to cure this depression, are you?

Senator Brookhart: Yes, I think you and the crowd that boss you could.

Mr. Whitney: I did not know I was bossed.³⁹

Senator Brookhart's demand to know why Whitney and his fellow financiers gutted the savings of America's farmers demonstrates the anger that many people from the country's interior felt towards East Coast elites. Brookhart's disgust with finance in general is apparent throughout his opening statement, which references back to 1920, not 1929, as the beginning of the end for American agriculture. To Brookhart, the problems brought about by the Great Depression are not traceable back to the Great Crash in 1929. Instead, the depletion of wealth in the agricultural sector is noticeable further in the past, at the beginning of the Roaring 20's, which saw the rise of the Republican Consensus and the subsequent proliferation of finance throughout America. Brookhart's words are more than a statement meant to challenge Whitney's cool demeanor; they are an expression of the intense frustration felt by many Americans nearly three years after the Great Crash initiated the Great Depression.

While Brookhart's anger is understandable in light of the suffering that many of his constituents experienced following the Great Crash, his disrespect for Whitney and failure to appreciate the complexity of finance transforms his righteous indignation into little more than inquisitorial bombast. By claiming that Wall Street had the means to make the suffering of America's farmers disappear overnight and through his references to the crowd that "bosses" Whitney, Brookhart forsook the moral high ground and opened the Commission to charges of unfairness. Senator Brookhart had no desire to understand the role of Wall Street and finance to the overall economy, so he simply pointed the figure at financiers because that was the easiest course. Like much of the

³⁹ *Hearings before the Committee on Banking and Currency Pursuant to S.Res. 84 and S.Res. 56 and S.Res. 97. : 1932 - 1934 (1934), 50-51.*

early proceedings of the Commission, it showed a willingness on the part of senators on both sides of the aisle to fall back on easy scapegoating rather than work to actually identify and understand the reasons behind the Great Crash.

While Norbeck and Brookhart's questioning was driven by a desire to publicly chastise bankers, other senators were able to more clearly address one of the fundamental problems raised by the Great Crash. As larger and larger numbers of people lost their investments in bankrupt companies, the issue of disclosure became an important topic in the incipient field of financial regulation. What was the proper level of financial disclosure for companies traded on public stock exchanges? Senator Carter Glass, a Democratic senator from Virginia, called on Whitney to answer this question during a portion of testimony concerning the United Corporation, a company backed by J.P. Morgan that lost nearly all of its value during the Great Crash. The following exchange highlights the ways in which political persuasion influenced both men's language as well as perception of the role of the financial industry.

Senator Glass: What I am trying to know is what percentage of the 120,000,000 (then the population of the United States) had any knowledge whatsoever of the intrinsic value of the stocks in which they were investing, to use a polite term?

Mr. Whitney: Senator Glass, I know of no corporation that has been more in the forefront in presenting absolute facts and all facts than the United Corporation. If the people of this country, investors or speculators, do not choose to make a study of those facts which are available to them

throughout this country, I do not know that either the corporations or the members of the brokerage fraternity are to be blamed.⁴⁰

The question posed by Senator Glass, with its reference to the entire mass of people within the United States, seems to deliberately contrast the investing public with the financiers of Wall Street. The senator's use of the phrase "polite term" when referencing investing indicates an intense suspicion of an activity that is integral to the financial industry. The suspicion held by both Glass and Norbeck was that Wall Street was selling securities at inflated rates to improve their own commissions, without any concern for the true, intrinsic value of the securities. Whitney was able to counter with a point that would remain a pillar of Wall Street's defense on Capitol Hill throughout the length of the Commission. The specter of personal responsibility must hover over all investing decisions. No one was forced to invest in the United Corporation or any other company; brokerages and corporations cannot be blamed for the losses of investors who knowingly put their money at risk when they buy stock.

Studying the disclosure issue would continue to be an integral part of the Commission's inquiry throughout its existence, and Whitney's call for personal responsibility would lose some of its power as more details were revealed concerning the lengths companies would go to hide information from the investing public. However, on this first day of testimony, Whitney demonstrated that the financial industry would not meekly take responsibility for the Great Crash. More than anything else, Whitney's testimony showed that the Congressional investigation of Wall Street would be met with an impassioned defense from an industry that felt itself unfairly under attack.

⁴⁰ *Hearings*, 22.

Things went from bad to worse for the Commission when revelations came to light that the new lead investigator, William Gray, was a personal friend of one of the short sellers who testified before the Committee, going so far as to “dine with him on the day of the examination.”⁴¹ Gray’s undisclosed relationship encapsulated all that was wrong with the link between Washington and Wall Street in Norbeck’s view. The cronyism and connections that marked Republican administrations throughout the 1920’s had seeped into Norbeck’s own investigation, contaminating it in a way that left Norbeck no better than the senators whose cozy relationship with Wall Street he despised. Norbeck had no choice but to remove Gray from his position, leaving him with no investigator, a public hostile to his aggressive tactics, and a re-election challenge that required his attention in South Dakota.

With nothing accomplished and his grand hopes for the Commission dashed, Norbeck suspended the investigation indefinitely, hoping to re-open the inquiry following the November election. Norbeck’s great crusade against Wall Street was seemingly finished, his hopes for a challenge to the supremacy of Wall Street dashed. Most painfully for Norbeck, it was yet another example of the triumph of the pro-business wing of the Republican Party over his own brand of Progressivism.

Enter Pecora

Having secured his re-election in early November, Norbeck returned to Washington with the hope that his suspended investigation could be restarted with better preparation and a more qualified lead counsel. Once again, finding someone willing to

⁴¹ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 51.

the lead the investigation proved problematic, as the issues that plagued the initial search were only exacerbated by the witch-hunt allegations that arose after Whitney's testimony.

The most qualified man to lead the investigation, particularly due to his lack of ties to Wall Street, was Samuel Untermyer. A longtime critic of Wall Street business practices and veteran of Senate investigations, Untermyer had experience with finance through his participation in the formulation of securities regulation by the State of New York.⁴² In nearly every way, Untermyer was the perfect candidate to join Norbeck on his crusade against Wall Street. Unfortunately for Norbeck, Untermyer refused to take part in the investigation.

With a newly elected Democratic President and Democratic majorities in both houses of Congress, Untermyer saw no reason to attach his name to a Republican-led investigation that would end, along with the lame-duck session of Congress, in March 1933. Untermyer undoubtedly hoped to play a role if and when Democrats in the Senate decided to form their own investigation into Wall Street, and he felt that Norbeck's investigation was not broad enough to address all the issues that needed attention.⁴³

Following Untermyer's rebuff, Norbeck began searching for anyone willing to give his dying investigation one last opportunity. Norbeck identified a lawyer named Irving Ben Cooper, an attorney from New York who had worked on uncovering corruption in Tammany Hall, as a potential lead investigator. With a background in searching for fraud hidden by powerful institutions, Cooper seemed like a good fit for Norbeck's purposes. Norbeck even managed to get more funds appropriated to his

⁴² "Untermyer Urges Stock Regulation," *The New York Times* 9 Jan. 1933.

⁴³ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 53.

Committee so he could pay Cooper more than the small sum that had been in place before.⁴⁴

When Cooper's appointment was announced, the Committee received its first wave of positive press, with *The New York World-Telegram* writing that the Committee might finally be roused from "lull and oblivion."⁴⁵ Norbeck's investigation seemed back on track, and the next week was spent identifying which financiers should be subpoenaed and made to testify before the Committee. It was during this debate that the brief window of success for Norbeck slammed shut, with Cooper resigning after he was denied the right to issue subpoenas to whomever he wished without approval from Norbeck. The chairman of the Committee refused to lose control of his own investigation, even if it meant firing one of the few qualified people who had been willing to participate in the investigation.

Faced yet again with no investigator and little time before his chairmanship expired, Norbeck came across the name of yet another New York attorney who had made his name fighting fraud in New York City. Ferdinand Pecora, former New York district attorney and now partner at his own private practice, was seemingly qualified—if his lack of financial experience was not held against him. Another problem existed that was not related to Pecora's legal background; it was his personal background. Born in Sicily, immigrant to the United States at an early age, raised in New York City, Pecora represented everything about a newly emerging America that made Norbeck uncomfortable.

Italian Immigration and American Nativism

⁴⁴ "Cooper Heads Market Inquiry," *The New York Times*, 11 Jan. 1933.

⁴⁵ *New York World Telegraph*, 12 Jan. 1933.

When he first stepped onto American soil in 1886, Ferdinand Pecora was only a four-year-old boy, joining his family and millions of other Europeans in a great migratory wave that reshaped the demographics of America. Pecora and his family were coming to America for the same reason that many earlier immigrants had, in search of religious freedom. As a convert to Protestantism on the overwhelmingly Catholic island of Sicily, Pecora's father was looked down on "by their friends and neighbors, and even by their own blood" for his decision to leave the Catholic faith.⁴⁶ Confronted with a life of hardship and discrimination at home, Luigi Pecora set off for America in 1883 and sent for his family three years later. While the America that Pecora and his family reached in 1886 was more religiously tolerant than Sicily, the impact of immigration had created a growing anti-Italian sentiment across the country.

The changes in America reflected by growing urbanization and the rise of Wall Street were accompanied by cultural shifts related to immigration, and the suspicions that men like Norbeck held for city slickers turned into all out racism in the case of Italian immigrants. When Pecora first arrived in America, he was welcomed by a country whose leading newspaper, *The New York Times*, could publish an editorial saying "Never since New York was founded [has there been] so low and ignorant a class among the immigrants...as the Southern Italians."⁴⁷ The Pecora's were part of a large exodus from Southern Italy to the United States in the final decades of the 19th century, the majority of whom were driven to America in hopes of better economic opportunities. The reaction of most Americans was revulsion and horror at this new type of immigrant, many poor and

⁴⁶ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 25.

⁴⁷ *The New York Times*, 5 Mar. 1882.

with no English language skills, particularly in comparison with the previous migratory waves from Northern and Western Europe.

The financial crisis of 1907 and ensuing recession pushed anti-immigrant rhetoric to new heights in the press, and led to the formation of the first congressional committee to investigate immigration and its impact on American life. The Dillingham Commission, named for Senator William Dillingham, sought to understand all aspects of immigration and then recommend to Congress any action that should be taken to amend immigration standards.⁴⁸ From its inception, the Commission was pressured by nativist groups across the country to address the arrival of immigrants from both Europe and Asia, and was populated by Congressmen who wanted to cut off the flow of immigration from areas deemed unseemly. Henry Cabot Lodge, Republican Senator from Massachusetts and Dillingham Commission member, even published a book entitled “Efforts to Restrict Undesirable Immigration,” illustrating the fear many Americans had of immigrants with whom they did not share similar religious and cultural backgrounds.⁴⁹ The nearly three-year long study of immigration published by Dillingham and his fellow Congressman in 1910 concluded, amongst other things, that Southern Italians “had little adaptability to highly organized society” while Scandinavians were “ideal farmers... and Americanize more rapidly than other peoples.⁵⁰” The preference for immigrants of Anglo-Saxon stock by members of Congress shaped the Commission’s work and its ultimate findings, as

⁴⁸ Katherine Benton-Cohen, “The Rude Birth of Immigration Reform,” *The Wilson Quarterly* 34.3 (2010).

⁴⁹ John Lund, “Boundaries of Restriction: The Dillingham Commission,” *University of Vermont History Review* 6 (1994).

⁵⁰ Immigration Commission, *Dictionary of Races and Peoples*, 82-120.

well as contributing to the further institutionalization of racist Italian stereotypes held by many citizens of the United States.

The end result of the Commission, beyond legitimizing the racist sentiments of many Americans, was a recommendation to restrict immigration from Southern and Eastern Europe while continuing to allow Northwestern Europeans to immigrate without regulation. Furthermore, Dillingham proposed a “reading and writing test as the most feasible method of restricting undesirable immigration,” which would allow the United States to turn away many potential immigrants from Southern and Eastern Europe.⁵¹ While Dillingham’s recommendation for a literacy test was never put into place, its widespread support was a reflection of the strong nativist sentiments that coursed through America as the 19th century faded from view.

The Dillingham Commission’s ultimate influence was not truly felt until the 1920’s, when a series of immigration reforms passed by Congress brought an end to the largely open-door immigration policy that had existed in the United States since its creation. The Emergency Quota Act of 1921 created a system in which annual immigration from any country could not exceed 3% of that country’s population residing in the United States in 1910.⁵² The law was amended in 1924 to reduce the population percentage to 2%, marking the triumph of nativist forces in preventing Italians and other “undesirable” immigrants from reaching the United States.

It was in this maelstrom over the nature of America and its inhabitants that Ferdinand Pecora grew up, one of thousands of Italian immigrants who settled into the tenement houses of New York City’s poorest neighborhoods. Pecora’s father worked as a

⁵¹ Immigration Commission, vol. 1, 48.

⁵² Emergency Quota Act, United States Statutes At Large § 8

shoe repairman, earning a living that allowed the family to survive if not prosper.

Encouraged to pursue an education by his parents, Pecora was a successful student who embraced America and its values, and later commented that he had no use for those immigrants “who still follow Old World ways and customs of life.”⁵³ Pecora graduated from the New York public school system at the top of his class in 1897 and entered the City College of New York.

With its lack of tuition, City College was the only realistic option for Pecora and many other immigrant children who grew up in destitute circumstances. Pecora arrived hoping to succeed at the institution responsible for the higher education of many Italian-Americans, but his education was quickly cut short by his father’s incapacitation.⁵⁴ Badly injured in a workplace accident at a shoe factory, Luigi Pecora was no longer capable of supporting his family, leaving the responsibility for providing for a family of seven children up to his oldest son, Ferdinand. In the era before working class people could expect disability payments following an injury sustained on the job, Ferdinand Pecora had to replace his father’s income and support his entire family before the age of 20. Pecora began working as a clerk in law offices across New York City, ultimately becoming a lawyer in his own right and a member of the New York State Bar over the course of the next fifteen years.

Pecora’s professional rise was accompanied by an increasing interest in politics, starting with the third party campaign of Theodore Roosevelt in 1912. Pecora delivered speeches in support of Roosevelt, traveling up and down New York to elicit support for

⁵³ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 29.

⁵⁴ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 32.

the Progressive candidate. Despite the failure of Roosevelt to win the 1912 election, Pecora came away from the experience with a deep-seated belief in the efficacy of Progressivism, rejecting the more radical political beliefs that gained traction amongst some immigrants.⁵⁵

Roosevelt's decision to not run for President in 1916 left Pecora unsure of his political future, but he eventually decided to join the Democratic Party in New York City, a decision that would force him to join the powerful Tammany Hall political machine. A corrupt organization that controlled the Democratic Party in New York City, Tammany Hall was the only avenue forward for a young Democrat with political aspirations. Pecora benefitted from the organization's influence, rising up the ranks until he was selected to be a deputy assistant district attorney in Manhattan in 1918.

Although Pecora was never implicated in any of the corrupt actions of Tammany Hall, his decision to even associate himself with such an organization raises questions about the devotion Pecora actually had to Progressive causes. In tandem with a belief in economic individualism, the Progressive movement was defined by its quest to root out corruption from the American political system. By joining Tammany Hall, Pecora must have realized that he was turning his back on the fundamental values of Progressivism to further his own career. Why Pecora decided to make such a decision is unknown, but it is a poor reflection on a man who sought to portray himself as a Progressive champion throughout his post-Commission career.

Pecora remained at the district attorney's office for the next eleven years, eventually becoming the chief assistant district attorney, responsible for prosecuting a

⁵⁵ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 33.

wide variety of cases. One case in particular, the prosecution of bucket shops that peddled fake securities to unwitting investors, was Pecora's only real tangle with the world of finance during his eleven years in office. The investigation led him to believe that a lack of regulation over the financial industry left financiers' "own conscience" as the only "restrictive force" over their behavior.⁵⁶ Pecora's beliefs concerning financial regulation would be of little significance until years later, when Bainbridge Colby, a former Secretary of State and leader of the New York Progressive Party during its 1910's heyday, recommended Pecora to Senator Peter Norbeck, who was scrambling to find a way to restart his investigation of Wall Street.

Mr. Pecora Goes to Washington

Pecora was only available as a potential counsel due to his falling out with the Tammany Hall machine, which grew increasingly wary of his investigations into organizations connected to its leaders. By 1929, Pecora had been forced out of the district attorney's office in favor of another attorney more sensitive to the needs of a corrupt political machine. Moving into private practice, Pecora found himself financially comfortable but intellectually bored. When he received a phone call from a South Dakota senator on January 22, 1933, he was looking for a new challenge. The invitation to spend six weeks in Washington summarizing the previous work of Norbeck's Commission was not the same offer that had been given to Untermeyer and Cooper, but it was opportunity that Pecora accepted.

When Pecora arrived at the Senate Office Building on January 23rd, he was uncertain of the role he was being asked to play in Norbeck's investigation. Undoubtedly

⁵⁶ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 38.

wanting to play a larger role than the one outlined by Norbeck over the phone, Pecora asked Norbeck for a copy of the Senate resolution authorizing the investigation. Pecora pointed out that the resolution granted a broader mandate than the one Norbeck had been pursuing. While Norbeck had so far directed the investigation towards uncovering the short sellers whom Hoover blamed for the Great Crash, the actual mandate authorized by the Senate called for,

“A thorough and complete investigation of the practices with respect to the buying and selling and the borrowing and lending of listed securities upon the various stock exchanges, the values of such securities, and the effect of such practices upon interstate and foreign commerce, upon the operation of the national banking system and the Federal Reserve system, and upon the market for the securities of the United States government.⁵⁷”

Pushing Norbeck to expand the investigation beyond short selling and into the world of investment banking and securities issuance, Pecora managed to show off the rhetorical talents which had led Colby to recommend him to Norbeck in the first place. Pecora convinced Norbeck that by expanding the investigation it would be easier to uncover the roots of the financial mess created by the market crash of 1929. Following the meeting, Norbeck decided the aggressive attorney was the right fit for lead investigator and announced Pecora's appointment the next day. Remarking that Pecora “would have all the authority to make a comprehensive investigation,” Norbeck signaled the return of his investigation of Wall Street. With an expanded mandate and an eager

⁵⁷ *Hearings*, 1.

investigator, the Senate Committee for Banking and Currency's investigation into Wall Street was ready for action.

Chapter Two: The Turning Point

*"Sunlight is said to be the best of disinfectants."
-Louis Brandeis*

Setting the Stage

As Ferdinand Pecora walked up the steps of the Senate Office Building on a cold day in February 1933, it seemed as if the Senate investigation into Wall Street's investment practices was quickly heading towards irrelevance. In fact, bankers had managed to overtake the national conversation concerning the Great Depression, persuasively arguing that they, as the trusted stewards of American finance, were the only men capable of directing the economy back to the heights it had reaching during the Roaring 20's. Their recommendation of lower taxes and minimal government intervention did not appeal to the growing ranks of Americans descending into poverty, but it was largely accepted by a Hoover administration wildly grasping for any way to combat the economic problems facing America.⁵⁸

The Republicans who controlled the Senate until March 1933 seemed to trust the advice of the bankers as well, allowing the Commission that Pecora was charged with leading to languish from a lack of investigatory powers. Pecora himself was a strange choice to lead the Senate investigation into banking practices, as he had little experience with finance and even less with Senate investigations. His poor background and Italian roots did not help either, as Pecora was the face of a new, multi-ethnic America that many sought to blame for the economic problems of the early 1930's.⁵⁹ The prejudice that existed in America at the time was on full display after the announcement of Pecora

⁵⁸ Ferdinand Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, New York: Simon and Schuster, 1939, 5.

⁵⁹ "Wealth on Trial," *Time* 12 June 1933.

as the new lead investigator of the Committee, with Time Magazine describing him as “kinky-haired, olive-skinned, and jut-jawed.”⁶⁰ The gulf that existed between Pecora and the chairmen of the country’s biggest banks formed the backdrop to every testimony, with Pecora representing the populist sentiment demanding a scapegoat for the market crash and the bankers embodying the well-educated elite who looked down upon the masses.

Appointed to the position of lead investigator by Senator Norbeck only weeks before the end of the Commission’s time frame to investigate Wall Street, Pecora’s last opportunity to establish that Wall Street had used nefarious methods to power the great financial bubble that burst in October of 1929 was rapidly approaching. Pecora needed to identify why his predecessors had failed to make any progress in uncovering fraud on Wall Street, and devise a new strategy that would allow the investigation to live up to Senator Norbeck’s initial hopes of national significance. The primary problem that bedeviled the investigators before Pecora was the two-pronged information gap that existed between Wall Street and those hoping to discover its secrets.

First, the men who ran the country’s leading banks had an understanding of finance honed by decades of experience, while Ferdinand Pecora had just a few weeks to bring himself up to date on the complex inner workings of the nation’s largest financial institutions. Gaining the sort of familiarity that bankers had with financial terminology was an impossible task to achieve in such a short period of time. From the beginning, any banker testifying before the Commission would have an advantage, purely based on his professional experience. The second aspect involved a refusal by the banks to open their

⁶⁰ "Wealth on Trial," *Time* 12 June 1933.

records to federal investigators, a situation that had prevented Pecora's predecessors from finding any evidence to back up their claims of fraud. The reticence of the banks and the lack of subpoena power by federal authorities allowed financial institutions to keep internal financial documents hidden from the eyes of investigators. Combined, a lack of both specific and general financial knowledge had doomed the investigation from the start, giving Wall Street a competitive advantage in Washington. It seemed as if the Senate investigation was just another example of Wall Street writing its own rules.

To Pecora, the irony of this situation was clear; the whole point of the investigation was to force banks to be more transparent. Banks were using the same strategy to keep out federal investigators as they had to sell securities all over the world. By maintaining that they should be the trusted arbiters of the financial system, bankers had been able to create an information gap between themselves and the general public that was insurmountable.

Pecora drove this point home to Norbeck in their initial meeting, pressing for a broader mandate to investigate Wall Street. Norbeck granted Pecora's plea for expanded investigatory powers, and subpoenas were sent out to the country's biggest banks on February 8th, 1933.⁶¹ Faced with the prospect of a public fight with the federal government, National City Bank acceded to Pecora's demand to see their internal records and finances the next day. It was Pecora's first triumph as lead investigator, but the chances of uncovering anything of value remained small. Pecora and his team of assistants would have less than a month to look over years of financial data with limited

⁶¹ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 70.

knowledge of the industry, and National City Bank was considered one of the great financial institutions of America.

Simultaneously, Pecora had to prepare for his first cross-examination before the Senate Commission. Samuel Insull, Jr., the son of disgraced financial wizard and utility magnate Samuel Insull, Sr., was coming before the Commission to face allegations that his family's empire had been built through the manipulation of securities markets. Although not directly a part of Wall Street, the collapse of the Insull Empire was one of the highest-profile bankruptcies caused by the Great Crash of 1929. Norbeck told the press that the cross-examination would be "the most sensational yet," vowing that the Commission's expanded mandate would produce results.⁶² It was up to Ferdinand Pecora to prove the senator correct.

The King of Power

The success of Samuel Insull Sr. was viewed during the 1920's as evidence of America's rise to economic prominence, an inspiring story of an immigrant from England who had come to America in search of opportunity and built a massive fortune. By 1929, Insull was in charge of the third largest utilities conglomerate in America, using a web of holding companies to control the utilities that produced more than one eighth of the country's electric power.⁶³ Insull had become the King of Power to many Americans, but the market crash of 1929 revealed that the emperor had no clothes. Insull's empire was built through the aggressive use of leverage and debt, allowing Insull and his sons to gain control of hundreds of utilities companies through the issuance of bonds to the general

⁶² Michael A. Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, New York: Penguin, 2010, 112.

⁶³ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 227.

public. Insull financed his acquisitions of utilities companies by turning to investment bankers, who happily enabled Insull's desire for growth. By the time that the market crash revealed Insull's complete inability to pay back his companies' accumulated debt, Insull was in charge of 255 utilities companies.⁶⁴

After the market crash, Insull fled to Europe to escape charges of mail fraud tied to the bankruptcy of his empire. His flight abroad convinced most Americans that Insull was guilty of something; it was Ferdinand Pecora's job to uncover the truth behind the collapse of the Insull Empire. Pecora began his cross-examination of Insull's son and chosen successor on February 15th, charged with confirming Norbeck's assertion that the Insull testimony would produce sensationalist headlines. Unfortunately for Pecora, Insull Jr. was no haughty investment banker who looked down on the Commission. Instead, he came across as the befuddled son of man who had bought too readily into the idea that the American economy would never stop growing. Pecora admitted afterwards that Insull Jr. seemed "more bewildered than anything else," no more capable of understanding the Insull Empire than the average American. Owen Young, Chairman of General Electric and the largest bondholder affected by the Insull bankruptcy, lamented that Insull Sr. was "the victim of that complicated structure (the Insull interlocking web of companies) which got even beyond his power, competent as he was, to understand."⁶⁵ Insull's testimony raised an important question that Pecora needed to answer: What differentiated criminals from bad businessmen?

⁶⁴ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 232.

⁶⁵ *Hearings before the Committee on Banking and Currency Pursuant to S.Res. 84 and S.Res. 56 and S.Res. 97. : 1932 - 1934 (1934)*, 1516.

In attempting to demonstrate fraudulent practices by the American financial community, Pecora had to prove that financiers and executives purposely and knowingly circumvented the law. In the case of Samuel Insull Sr. and his sons, this was simply not the case. Insull was a business failure, not a criminal. The distinction between these two characterizations would constantly loom over the Commission, threatening to derail it on multiple occasions. Nearly every man who came before the Commission claimed that they were not guilty of anything more than believing in the long-term growth of the American economy. Critics of the Commission pointed out that American businesses could not take risks if the threat of a Congressional investigation loomed over every failure.

In many ways, the Commission's critics hit upon a theme that would raise substantive questions about Pecora's approach to the investigation. Pecora's aggressive questioning seemed to be driven by his political background as a Democrat, and his desire to castigate innocent men like Samuel Insull Jr. only reinforced beliefs that the Commission was more concerned with identifying a scapegoat than actually addressing the financial problems of the country. Furthermore, Pecora's cross-examinations came perilously close to challenging the right of businesses to take any risks at all. As his critics rightly wondered, did Pecora believe that any business opportunity with a chance of failure was fundamentally wrong? Pecora never addressed this criticism forcefully, allowing both contemporary and modern observers to wonder whether the Pecora Commission was driven more by populist political motivations than by a desire to actually discover who was accountable for the Great Crash.

The failure to identify any evidence of fraud connected to Samuel Insull Jr. demonstrated the difficulty of differentiating between those who played an active, knowing role in creating the atmosphere that led to the Great Crash and those who were simply swept up in the investment mania that spread throughout the country during the 1920's. Pecora's questions indicated that he thought financiers were fully aware of the massive risks being taken and the possibility of even larger losses. Such assumptions were understandable, but not necessarily backed up by fact. Pecora's failure to tie any fraud to Insull Jr. proved the potential hollowness of Pecora's thesis concerning Wall Street. Ultimately, the only way for Pecora to legitimize the Commission was to identify the people who used the excuse of failure to hide something more sinister.⁶⁶

The only way to do this was to take advantage of the new subpoena powers that had given Pecora access to the internal records of the country's biggest banks. By removing the veil of secrecy that prevented outsiders from understanding the inner workings of banks, Pecora could see the honest opinions of the country's bankers. Closing the information gap between the public and banks was Pecora's only hope for demonstrating the need for reform on Wall Street.

With this lesson in mind, Pecora turned his thoughts to the country's largest bank, National City Bank. Pecora himself remarked that the prestige and reputation of National City Bank was "enormous," reflective of its status as a "super-bank."⁶⁷ With only a crash course in financial analysis to his name and little time to examine the vast inner workings of National City Bank, Pecora marched into the hearing room to face off with the man

⁶⁶ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 120.

⁶⁷ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 71.

who had long embodied financial success and honesty to most Americans—Charles Mitchell, the chairman of America’s largest bank.

Introducing Mr. Mitchell

Charles Mitchell, or “Sunshine Charlie”, represented the American Dream in living, breathing form. Born into modest circumstances in Chelsea, Massachusetts (the hometown of Horatio Alger), Mitchell quickly rose to become the leader of National City Bank, entrusted with running the nation’s largest financial institution.⁶⁸ Mitchell’s nickname was a product of his relentless optimism concerning both the American economy and National City Bank, a trait that served him well during the boom years of the 1920’s. Even in the face of increasingly negative economic news during the early 1930’s, Mitchell retained his sunny disposition and maintained that the crisis that would eventually become the Great Depression was simply an economic aberration.

Mitchell’s success was based on his work as one of the most successful salesmen in American history. He reinvented securities markets by taking high finance from the boardroom to the living room, pushing investing on Americans eager to take part in the market boom of the 1920’s. He transformed National City Bank into the most powerful bank in the country, raising its stock value by over \$100 million during his tenure as chairman.⁶⁹ By demanding that his salesmen grant a greater and greater number of Americans access to the potential profits of financial markets, Mitchell transformed people of all backgrounds into amateur investors and bond market aficionados. Mitchell called on his salesmen to seek out investors in the form of “persons of limited resources,

⁶⁸ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 71.

⁶⁹ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 72.

all of whose capital and income are necessary to insure life's comforts.⁷⁰ Mitchell's success in opening up all segments of America to financial markets was copied by his competitors, and by 1929 the savings of Americans across the country were tied up in financial markets.

While Pecora would eventually attempt to attach blame to Mitchell for exposing so many Americans to losses in securities markets, Mitchell's work in the 1920's undoubtedly gave more Americans access to the profits being enjoyed by the country's growing corporate sector, and he cannot be faulted for seeking to increase the power and reach of the institution he was charged with leading. In the context of the Great Crash and Great Depression, Mitchell may come across as a soulless businessman driven by profit and nothing else. This approach comes perilously close to historical myopia, seeking to define Mitchell's action by events that he, arguably, could not have foreseen. He certainly was not the only person caught off guard by the Great Crash. Mitchell's work to give more Americans access to securities markets had both positive and negative effects, but, more substantially, it marked the beginning of a new era of influence for major financial institutions.

Mitchell pioneered the transformation of staid commercial banks into risk-taking investment banks, forever changing the way Wall Street made money. Prior to the arrival of Mitchell, National City Bank and its competitors relied on deposits as a source of cash and short-term loans to well-scrutinized businesses to grow that cash. In the age of Mitchell, banks took advantage of securities sales to earn commissions on the sale of both

⁷⁰ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 76.

government and company debt. The most important consequence of this change in how banks made money was its implication for the ways in which banks viewed risk.⁷¹

In commercial banking, bankers would give out loans to companies that could demonstrate an ability to eventually pay back the loan, making the financial health of the company seeking the loan a matter of great importance. The fear of losing an investment because of a company's bankruptcy forced banks to scrutinize potential loan agreements closely. With the rise of investment banking in the early part of the 20th century, banks became able to make money through selling securities to the public, acting as the middleman between institutions and the investing public. When institutions wanted to raise capital, they turned to investment banks to identify either individuals or other institutions willing to trade capital for ownership of stock or debt.

Investment banks earned money by charging a commission on every transaction between the equity or debt issuer and purchaser. The nature of the securities sales business meant that banks earned money for selling a company's securities, not holding them. While banks such as National City did have to scrutinize securities issuers to ensure that customers would continually return to National City for future securities purchases, the bank's own money was not at stake in the way it was with commercial loan transactions. Therefore, banks had less incentive to scrutinize whether a company had the ability to eventually pay off the securities they were issuing; the actual financial health of a company had no relation to the fees a bank earned. Instead, the size of the securities sale was what determined the bank's commission, and the easiest way to

⁷¹ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 75.

increase the bank's commission was to sell more securities. Mitchell demanded his employees do just that.⁷²

The true success of Mitchell's marketing and sales strategies were not fully realized until October 1929. The stock market crisis quickly metastasized from a financial problem to a broader decline in the overall economy, in part due to the increased exposure to financial markets caused by Mitchell's securities salesmen. Yet Mitchell largely escaped blame for both the Crash and ensuing Depression, portraying himself as the white knight that did everything in his power to save the day in the face of short-sellers who, in his opinion, were the true criminals who traded American prosperity for quick profits in the tumultuous final months of 1929. Herbert Hoover agreed with Mitchell's conclusions, and condemned short selling in a futile attempt to arrest the precipitous fall of American stocks.⁷³

In this regard, Mitchell was not being as disingenuous as Pecora would ultimately portray him. Mitchell did spend a significant portion of his vast wealth in an attempt to arrest the Great Crash, ultimately losing a considerable amount of money. Pecora overlooked this act because it ran counter to his narrative of selfish bankers out of touch with real Americans, but any honest rendering of Mitchell's actions during the last few months of 1929 must take into account his attempt to stop the stock market's plunge. Critics of Mitchell could point out that any effort on Mitchell's part to prop up the stock market was driven by a selfish desire to save his own fortune. While this might be true, that is the way capitalism is meant to function. Mitchell might have been acting in his own self-interest, but his interests were aligned with every person who owned a share of

⁷² Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 91.

⁷³ "Hoover Takes Credit for Ban on Short Sales," *The Pittsburgh Press* 20 Feb. 1932.

stock. To take issue with Mitchell's actions in October and November 1929 is take to issue with the fundamental principles of Adam Smith.

When Pecora called on Mitchell to testify before the Commission, Mitchell's success as a salesman had extended to the realm of public opinion, where he largely escaped scrutiny for his role in the financial crash. By deftly deflecting blame onto faceless short sellers, Mitchell managed to control the narrative of the stock market crash and turn attention away from his bank's role in exposing millions of Americans to the risks of financial markets. As mentioned above, Mitchell was one of the leaders of a consortium of bankers who bought a number of blue-chip stocks well above their market price in October 1929 in a failed attempt to stabilize the stock market, and he did not shy away from portraying himself as one of the biggest personal losers from the market crash.⁷⁴

Although he could point to his losses as evidence of the Great Crash's vast range, Mitchell's personal wealth remained immense in comparison with most Americans, and he strode into the Senate Office Building safe in his position as a titan of American finance. His easy confidence was unambiguously in contrast to the pressures mounting on Ferdinand Pecora, who was facing his last opportunity to identify the ways in which Wall Street could be held accountable for the Great Crash of 1929.

The Inevitability of Income Taxes

The opening day of Charles Mitchell's testimony coincided with "the nadir of the Depression," with numerous banks folding and holidays being declared across the country to save still-existent banks from ruin. Only a few days later, National City Bank

⁷⁴ *Hearings*, 1811.

would close its doors at the behest of the newly inaugurated president, Franklin D. Roosevelt. It was during this period that Ferdinand Pecora said, “A whole era of American financial life passed away.⁷⁵” The backdrop of financial destruction encouraged Pecora to go after Mitchell, confident that the financial problems afflicting the country were the product of bankers such as Mitchell pursuing excessively risky profit-making schemes.

Amid this maelstrom, Charles Mitchell began his testimony, largely occupied with his version of the events that unfolded during the days and months following the market crash in October of 1929. Mitchell portrayed himself as the man who threw his fortune “into the breach” in a selfless attempt to save one of the country’s most important financial institutions.⁷⁶ Pecora allowed Mitchell to speak at length about his good deeds, seemingly too intimidated to challenge the great financier. Only towards the end of the first day of testimony did Pecora raise a topic that seemed somewhat innocuous in testimony concerning the stock market crash—income taxes.

Pecora began by asking Mitchell to outline his holdings in National City Bank, which Mitchell took as an opportunity to reinforce his argument that he had suffered greater financial losses than almost anyone during the market crash. Mitchell’s efforts were rebuffed by Pecora, who focused in on one particular transaction close to the end of 1929. Mitchell had sold a significant portion of his National City Bank stock near the end of 1929, only to buy back that same stock in early 1930. Senator Smith Brookhart, an Iowan Republican who sat on the Committee, pressed Mitchell on the prices at which he had sold and bought back the stock. Only then did Mitchell admit, “I sold the stock,

⁷⁵ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 70.

⁷⁶ *Hearings*, 1812.

frankly, for tax purposes.⁷⁷ Senator Brookhart continued to push Mitchell, asking whether he had used the sale of stock in late 1929 to report a loss on his income statement. When Mitchell replied in the affirmative, the Pecora Commission was transformed from a sleepy congressional hearing into national news.

Mitchell openly admitted that he had sold 10,000 shares of National City Bank for roughly \$375 per share at the end of 1929, allowing him to report a loss of over \$2 million on his income tax statement due to the decline in the value of National City Bank shares from their peak of \$576 per share in early 1929. Although Mitchell bought back the shares for the same price in 1930 and took home over \$1 million in salary during 1929, he paid no income tax for the year 1929.⁷⁸ Furthermore, the broker who had purchased the shares from Mitchell and then sold them back for the same price turned out to be none other than his wife. Mitchell's tax dodge occurred in the depths of the Great Depression, reinforcing the vast disconnect between the leaders of financial institutions and the average American.

Mitchell's admission was clear evidence that he was not as innocent as he had led the public to believe. Yet, what was Pecora doing focusing on one person's income taxes when he was supposed to be investigating the problems of the entire American financial system? Clearly, Pecora felt that attacking Mitchell on a personal issue would ultimately strengthen his case for regulating the banking industry in general. While this may have been an effective prosecutorial strategy, it had no place in a serious investigation of Wall Street business practices. In fact, it was evidence of Pecora's questionable reliance on populist rhetoric to raise the ire of the millions of people impacted by the Great Crash.

⁷⁷ *Hearings*, 1812.

⁷⁸ *Hearings*, 1813.

Castigating Mitchell did nothing to solve the problems that helped cause the Great Crash, but it did make people feel better about their own problems when they saw a Wall Street titan cut down to size in public. In the case of both Insull and Mitchell, Pecora seemed all too willing to attack the characters and morals of the men he was cross-examining, even if such tactics were of negligible importance to his goals as lead investigator.

Pecora quickly moved to strengthen his point that bankers had little concern for either their shareholders or the public at large by dwelling on the bonus payments Mitchell received throughout his tenure as chairman of National City. Pecora told his audience that Mitchell had paid himself over \$3 million in bonus payments in the years leading up to the Great Crash, even granting himself a \$1 million bonus in 1929.⁷⁹ Pecora's decision to hammer Mitchell on the topic of bonus payments was another obvious attempt to engender populist rage at overpaid bankers, but in this case Pecora was also driven by a desire to connect outsized bonuses to outsized profits. According to Pecora, the bonuses were connected to profits, and the profits were a symptom of excess risk and a lack of regulatory oversight.⁸⁰ Pecora wanted to build his case for greater oversight by showing how Mitchell had no incentive to curb unnecessary risk-taking by his employees; the riskiest securities sold by National City paid the same commission as the safest.

Unlike his handling of the income tax issue, Pecora's ability to tie a seemingly personal issue (one man's bonus) to a problem that impacted the whole of Wall Street signified Pecora's first substantive triumph during cross-examination. Pecora demonstrated that bonuses were tied to the quantity of securities sold, not the quality.

⁷⁹ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 116.

⁸⁰ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 120.

Such a situation was bound to encourage bankers to push risky securities on their customers, as bankers' personal wealth suddenly became tied to the volume of securities they were able to sell. Pecora showed the American public that Wall Street's business model was infested with a payment structure that incentivized irresponsibility and punished those who refused to peddle securities of questionable value.

While Pecora's points about the connection between large bonuses and questionable banking practices were well-founded, it was the words of Senator James Couzens, a Democrat representing Michigan, who most forcefully and eloquently summarized the reasons behind delving into the personal finances of the country's financiers. Unlike Pecora, who used the issue of salaries and bonuses to engender populist ire as well as to make a point about the role of compensation in risk-taking, Senator Couzens felt that the only legitimate reason to ask about issues of personal finance was when the public good was involved. As the following exchange shows, it was Senator Couzens who made this clear, not Ferdinand Pecora.

Mr. Pecora: Mr. Mitchell, is it not also the fact that for the year 1929 you received, by way of both salary and commissions, or participations in the management fund of the National City Co. and the National City Bank, a sum aggregating \$1,206,195.02?

Mr. Mitchell: May I have that figure again, because I have to check it up?

Mr. Pecora: \$1,206,195.02.

Mr. Mitchell: I will be glad to check that figure, and confirm it, or question it.

Senator Couzens: For the matter of the record, I want to say that this testimony is being elicited, not with the idea of going into the personal affairs of Mr. Mitchell, or the National City Co., but for the purpose of demonstrating publicly, if possible, that these unreasonable salaries and these bonuses lead to unsound banking and unsound sales of securities. I, as temporary chairman, want to make it plain that this committee is going into that for that very purpose, and not for the purpose of headlines or for the purpose of delving into individual people's personal affairs. I personally dislike this sort of thing, but I think that the public should know what inspires some of these sales, and some of these securities being foisted on the public. When I say that, it does not mean any reflection on the National City Co. particularly, but it is quite general, that where there are excessive profits and bonuses to employees and officials, it has been very detrimental to the public interest. I thought I ought to say that, because I disapprove of some of the questions that have been asked of Mr. Mitchell, but I see no other way of getting at it.⁸¹

Couzens' disapproval at the questions directed at Charles Mitchell indicates that it was not only conservatives and members of the financial community who found some aspects of the Commission reminiscent of an inquisition, with little relevancy to the serious topic of financial reform. In the eyes of Couzens and many others, Pecora was much more eager to take the easier route of populist pandering than the harder road of building a legitimate case for reform based on facts. Ultimately, the refusal by Pecora to

⁸¹ *Hearings*, 1779.

abandon obviously political tactics damaged his credibility and forces modern readers to view the rest of his cross-examinations with suspicion. Was Pecora trying to identify a way to regulate finance in a productive way, or simply drawing attention to himself and the Commission by focusing on issues like personal compensation?

Another exchange between Mitchell and Senator Couzens highlighted the differing ways in which Congress and Wall Street perceived compensation and its role in an efficient financial system, and allows Pecora's focus on personal compensation to be viewed in a better light. Senator Couzens wanted Mitchell to explain why National City Bank had set up management funds that gave each company executive a personal stake in the financial performance of the funds, despite the fact that the money used to create the management funds was the money of the bank's depositors. According to Mitchell, National City's executive committee would vote at the end of each year to assign fund managers different percentages of the profits of the management funds depending upon each manager's success at generating profits.⁸² Couzens found this practice troubling because it allowed bank executives to realize huge bonuses by risking other people's money without having to risk losing their own money in the process, as well as encouraging bank managers to take large risks in an effort to earn a larger percentage of the fund's profits at year-end.

Senator Couzens: And, as you look at it in retrospect, do you think that was a good system⁸³ to set up for a financial institution?

⁸² *Hearings*, 1772.

⁸³ Senator Couzens is referring to the practice of giving each executive involved in the operations of a management fund a percentage of the earnings of that fund.

Mr. Mitchell: Yes, I think so, and I would really feel quite strongly about that. I have seen it applied in the bank where it was established after I became president of the bank, and it establishes an esprit de corps and an interest in one officer in another officer's work that is to me most noticeable.

Senator Couzens: Does it not also inspire a lack of care in the handling and sale of securities to the public, because each individual officer has a split?

Mr. Mitchell: I can readily see, from your point of view, that that would seem so, and I must grant that it must have some influence. At the same time, I do not recall seeing it operate in that way.

Senator Couzens: You would not see it. Only the customers would see it after they had gotten the securities.⁸⁴

The debate over whether compensation should be used as a motivational tool demonstrates how the Commission came across issues that were relevant to all American business, not just those involved in the financial sector. Should the government dictate the ways in which a business sets up its compensation system? Seen through the eyes of Mitchell, forcing bank managers to compete against each other improved overall morale and created an atmosphere that benefitted the shareholders of the bank. Couzens interpreted such a policy in a completely different way, focusing on the ways in which National City's compensation system encouraged recklessness and short-term thinking instead of more responsible, long-term oriented investing. While Mitchell's insider

⁸⁴ *Hearings, 1772-1773.*

knowledge of the effectiveness of the system he put into place certainly adds credence to his opinion, Pecora's earlier work to point out the huge bonuses bank managers earned even in the face of economic decline meant that Couzens' perspective was the one accepted by both the Commission and the public at-large.

The combination of his over-sized bonus and income tax dodge meant Mitchell could no longer claim to be looking out for the public interest, and the national conversation concerning the market crash was transformed overnight. While Mitchell's testimony had little to do with the market crash, it demonstrated, at a minimum, that bankers were not as innocent as they claimed. The fundamental trust that was necessary for Mitchell to successfully market and sell the bonds and stocks that had powered his rise to the top of American finance was gone forever.

While Mitchell's testimony spelled doom for his career, its larger impact was on the national narrative concerning the market crash. The investment bankers who had long proclaimed that they had saved the country from an even worse economic fate were now faced with evidence of their selfish financial strategies. Mitchell became a proxy for the entire industry, a symbol of the richest strata of society abdicating any responsibility to those most affected by the Depression. By removing the veneer of respectability that bankers had used to deflect blame for the financial crisis, Pecora opened up the entire banking industry to criticism and empowered the Commission to dig deeper in search of fraudulent behavior.⁸⁵

The success of Pecora in undercutting Mitchell and his fellow bankers narrative was undeniable, but Pecora's usage of morally questionable tactics to drag a man's name

⁸⁵ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 130.

through the mud is a blemish that remains on Pecora's legacy to this day. Pecora focused on Mitchell's tax dodge because it reinforced the narrative Pecora wanted to push on the country, while, in reality, the truth lay somewhere in between Mitchell and Pecora's telling of the story.

Whatever his tactics, Pecora strode out of the hearing room after Mitchell's first day of testimony a new man, totally in control of the Commission that would ultimately bear his name. Mitchell was also transformed, a shell of the man who had confidently walked into the Senate Office Building only hours before. Yet, in the words of *Time Magazine*, the "damnation of Mitchell" was not yet complete, and Pecora still had many more questions for the disgraced banker.⁸⁶ As the first day of testimony came to a close, Pecora was ready to shift gears and pursue a new line of questioning, revealing the illegal structure of National City Bank and the ways in which Mitchell's bankers had manipulated average Americans in the continuous search for bigger and bigger profits.

The Damnation of Mitchell Continues

The revelation of Mitchell's tax evasion put him on the defensive from the start of the second day of his testimony, but Pecora opened his questioning with another seemingly innocuous topic. Instead of pressing Mitchell on the tax issue again or challenging Mitchell on a controversial issue such as stock manipulation, Pecora instead began with questions concerning the relationship between National City Bank and its largest subsidiary, National City Company.

While banking structure was a legal topic that did not easily lend itself to sensationalist headlines, Pecora identified National City Company as another way to

⁸⁶ "Damnation of Mitchell," *Time* 6 Mar. 1933.

challenge Mitchell's claim that bankers helped avert a larger economic depression. National City Company was an investment affiliate of National City Bank that was created in 1911 to allow the Bank to take advantage of the explosive growth of the international securities market during the 1910's and 20's.⁸⁷ Although laws were in place with the express purpose of preventing commercial and investment banks from existing together as one financial entity, National City Bank circumvented these laws by having its shareholders and officers of the Bank own all the stock of National City Company. Essentially, the legal office of National City Bank devised an ingenious method for the Bank to not technically own National City Company but still retain control of all of its operations. The financial threat posed by such an arrangement was not problematic in boom times, but the market crash proved why a separation of commercial and investment banks was thought necessary.

Commercial and investment banks were legally kept separate due to the very different business models that each type of bank operated under. While commercial banks were used to hold deposits and ease capital flows to businesses and individuals, investment banks contained sales and trading operations. These operations existed to sell securities as well as trade those same securities using the bank's money. The fundamental conflict of interest reared its head when investment affiliates (such as National City Company) gained access to the contact information of depositors of larger commercial banks (such as National City Bank). These investment affiliates were able to portray themselves as extensions of the commercial side of the bank, without revealing the much riskier nature of investing as opposed to simply depositing money. Particularly in an era

⁸⁷ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 79.

when financial markets were quickly opening up to average Americans for the first time, investment bankers were able to take advantage of widespread ignorance concerning securities markets.

Although the logic behind separating investment and commercial banks was sound, bankers did have legitimate reasons for advocating for the combination of the two entities. Commercial banks with investment affiliates were better able to serve all the financial needs of their customers, and the growth of the securities industry and subsequent profits during the 1920's meant customers were increasingly demanding investment services from commercial banks. Commercial banks were also the trusted holders of most Americans' money, and, as such, were largely assumed to attract and employ the best financial talent. Customers could not be faulted for wanting the same people whom they trusted to hold their money to also be responsible for investing it. The managers of banks further maintained that, unlike independent investment companies, which simply earned profits for their shareholders, consolidated financial institutions were able to loan out the profits of the investment bank through the operations of the commercial bank. In this way, integrated financial institutions would improve the efficiency of the financial system and allow small business and individuals better access to capital. Viewed through this lens, the separation of investment and commercial banks seemed to be an antiquated notion ignorant of modern financial realities.

While the underlying justification for the separation of investment and commercial banks was open to debate, the first bank to take advantage of legal loopholes to effectively operate as an integrated financial institution was National City Bank. The success of Charles Mitchell and his fellow securities salesmen was based on their ability

to convince the depositors of National City Bank to use some of their money to invest in securities markets through National City Company. By 1929, National City Company had 350 salesmen spread throughout 69 offices across America, using 11,300 miles of private wire to relay bond sales back to the New York headquarters. Sales competitions incentivized the marketing of financially shaky bonds to nearly 122,000 people in 1928. One sales contest, started just one month before the Great Crash, was deemed “the greatest sales contest ever held by National City Company,” promising “liberal cash prizes” for the most successful salesman. National City Company existed to sell securities that National City Bank could not, and sold an average of a billion and a half dollars of securities a year throughout the 1920’s.⁸⁸

National City Bank’s creation of an investment affiliate was not a secret to the federal government, and the United States Solicitor General had actually rendered two opinions condemning the illegality of National City’s banking structure. Frederick Lehmann, Solicitor General under President William Taft, had written in 1911 (the year National City Company was founded) that the creation of investment affiliates separate but wholly controlled by commercial banks was a clear attempt to circumvent the restrictions put in place by the National Banking Act. Fortunately for National City and most of Wall Street, nothing ever came of Lehmann’s briefs and a quick end to easy profits was avoided. In fact, by 1933 the original copies of Lehmann’s opinions could not be located, forcing Pecora to brandish a carbon copy, which he dubbed, “a ghost to haunt the conscience of the Bank.”⁸⁹

⁸⁸ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 72.

⁸⁹ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 81.

The general public had no idea that National City Bank had used complex legal maneuverings to sidestep banking law until Pecora raised the subject on the second day of Mitchell's testimony. Pecora pressed Mitchell on who controlled National City Company, ultimately causing Mitchell to reveal, "three trustees are the shareholders of all the stock of National City Company, and they hold the stock for the shareholders of National City Bank."⁹⁰ Mitchell then went on to reveal that the three trustees of National City Company were always members of the National City Bank board of trustees.⁹¹ After establishing that Mitchell and his fellow National City Bank trustees exerted complete control of the country's largest investment company (despite laws that existed to prevent this from occurring), Pecora went on to ask Mitchell if the three men who owned all the stock of National City Company ever reported to the thousands of shareholders of National City Bank. When Mitchell replied in the negative, Pecora had proved that not only did National City Bank use a legally questionable structure to pursue profits, but also that they did so without making their shareholders aware of their methods of revenue generation.

The consequences of National City Bank's methods were manifold, but the most important led to public demands for both stricter laws outlining acceptable bank structure as well as demands for more managerial accountability to shareholders. Legislators and the public-at-large now realized that laws governing banks were useless without a regulatory body to enforce them. The Republican administrations of Harding, Coolidge, and Hoover in the 1920's fostered a pro-business, anti-regulation climate in government, and the prosperity of the decade contributed to the idea that American businesses did not

⁹⁰ *Hearings*, 1813.

⁹¹ *Hearings*, 1813.

need any oversight. An example of the extreme laissez-faire approach of the Hoover administration was evident when, even after the stock market crash of 1929, Hoover felt that any attempt to regulate the New York Stock Exchange would be unconstitutional.⁹² Prior to the revelations forced out by Pecora's insistent questioning, banks were trusted to regulate themselves. Mitchell's second day of testimony put an end to the idea that a self-regulatory sentiment existed amongst the banks on Wall Street.

Although Pecora seemed to think the necessity of a regulatory body on Wall Street operated by the government was self-evident, the financial community could legitimately challenge such assumptions. First, how would such a regulatory body be created? If either Congress or the President created a financial regulator, would they also appoint its staff? In this case, the country's financial regulator would be a political body, subject to the same partisanship that afflicted the political institutions of the country. The impartiality of such a regulator would constantly be in question, with the financial community living in constant fear of political figures interfering in the operation of the financial system. Would financiers have to donate to political campaigns to ensure they were not the focus of business-destroying investigations? From another perspective, would firms be able to hire former regulators as a means of creating goodwill that would lead to a favorable regulatory environment? Such questions highlighted the problems associated with any attempt by the government to enforce its will on the business decisions of private citizens. On a fundamental level, ensuring the impartiality of a politically appointed body was an impossible task, particularly in the midst of the Great

⁹² Herbert Hoover, *The Memoirs of Herbert Hoover: The Cabinet and the Presidency, 1920-1933*, New York: Macmillan, 1952, 16-17.

Depression. What Democrat wouldn't want to be seen as the protector of Main Street against the nefarious influences of Wall Street?

Another problem raised by the financial community was the issue of the qualifications of members of a potential regulatory body. How could a regulator have a better understanding of financial markets than someone who worked within such markets every day? This issue was underscored by the role of Ferdinand Pecora in the Senate Investigation. Pecora, who had very limited experience with financial markets, had made clear throughout the investigation that he felt the Wall Street policy of self-regulation should be replaced by a regulatory regime unattached to Wall Street. Were bankers supposed to believe Pecora, who had never even worked in the financial industry, was better qualified to regulate the American financial system than men who had dedicated their lives to finance? The combined problem of who would appoint the members of a government-run regulator as well as who those members would be illustrated that solving the problem of regulation on Wall Street was not as easy as Pecora thought.

While bankers' concerns about the composition and role of a financial regulator were well founded, they did not persuasively make the case that an independent watchdog was unnecessary. A regulator with the legal capability of enforcing the rules passed by the democratically elected legislature was the only way to guarantee that Wall Street had any incentive to pay attention to acts of Congress. Laws would continue to be either circumvented or broken unless bankers knew that punishment was a real possibility. No amount of speechifying by financiers could change this simple fact of human nature.

In addition to the revelations about banking structure, the news that banks were able to own and control subsidiary companies without reporting the financial performance of these companies brought about a call for increased disclosure. A symptom of the dramatic decrease in public trust in banks was the demand for annual reports and full disclosure of subsidiary companies to shareholders, which finally occurred over two years after the Great Crash. Pecora himself wrote that, "The two chief instruments which facilitated these abuses were the investment affiliate and the secrecy with which the management was allowed to operate."⁹³ The revelations of Mitchell's second day of testimony set the stage for Pecora to focus in on one example of malfeasance at National City Bank that brought together the two chief instruments National City used to generate massive profits- the sale of Latin American government bonds to middle America.

The Curious Case of Peruvian Bonds

By the time Ferdinand Pecora got to the issue of Latin American bond sales on the sixth day of testimony, massive changes had already occurred due to the revelations of Mitchell's earlier testimony. After an additional two days of testimony that exposed the shoddy treatment of National City Bank employees by executives during the market crash, both Mitchell and Hugh Baker, president of National City Company, resigned their posts as the leaders of one of America's most influential financial institutions.⁹⁴ In addition, Mitchell was now under investigation by the Justice Department for tax evasion.⁹⁵ The epic fall of a titan of finance was nearly complete.

⁹³ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 130.

⁹⁴ "Wealth on Trial," *Time* 12 June 1933.

⁹⁵ "Wealth on Trial," *Time* 12 June 1933.

Despite his considerable progress in demonstrating National City Bank's problematic business model, Ferdinand Pecora had one last example to demonstrate the lengths bankers would go to create additional revenue in the years leading up to 1929. In fact, Pecora's decision to wait until the sixth day of testimony to raise the issue of Latin American government bond sales was a strategic one, intended to capture all aspects of National City Bank's questionable practices in one spectacular case.

Pecora picked one of the areas that powered National City Company's success in expanding the market for securities during the 1920's—the international bond market. Despite the fact that many Americans could not locate countries such as Ecuador and Peru on a map in the 1920's, Charles Mitchell's salesmen pressed their clients to take advantage of the worldwide economic surge by purchasing the debt of growing Latin American countries. The bonds of one country in particular, Peru, were marketed to Americans as a safe investment in a country with solid financials. National City Company chose not to reveal that, during the early part of the 1920's, the toxic nature of Peruvian bonds had forced National City to turn down an offer to issue Peruvian bonds. In an internal memo, National City bankers found that “the government treasury was flat on its back and gasping for breath” and the Peruvian government had “been careless in the fulfillment of its contractual obligations” in the past.⁹⁶ The dangerous nature of issuing bonds for such an unstable country was so obvious that National City could not in good conscience market Peruvian bonds to its clients.

As Pecora revealed to an astonished crowd that now gathered daily to hear what the newly famous lead investigator would disclose next, the decision to turn down the

⁹⁶ *Hearings*, 2053-2063.

offer to issue Peruvian bonds did hold for long. After an improvement in the finances of the Peruvian government, National City's bankers revisited the bond issuance and declared that the country offered a legitimate investment opportunity. The reason behind National City's change of heart can be distilled into the words of a National City banker named Victor Schoepperle, who remarked that the investment climate of the late 1920's convinced him that, "I was in a new era."⁹⁷ The optimistic belief in a new economic era revealed two insights into why the stock market crash of 1929 was such a shock to the bankers of Wall Street. Bankers felt that the prosperity of the 1920's was not the product of a particularly long business cycle, but actually the dawn of a new type of economic order in which recessions and depressions no longer existed. Furthermore, the capacity for self-delusion in a time of prosperity knew no bounds. Bankers wanted to believe that prosperity had become permanent because that was in their best interest. As Schoepperle said in his testimony to the Commission, the late 1920's "was an optimistic era in which optimistic interpretations were put on any situation where the pros were about equal to the cons."⁹⁸

Spoken in the midst of the Great Depression, Schoepperle's words seem difficult to comprehend. Yet, his point is one that Pecora had trouble combating throughout the investigation. Schoepperle and his fellow securities salesman had no malicious intent to defraud investors; they truly believed that the economic boom of the 1920's was one that defied the accepted logic of economics. Did any real means exist to prevent potentially risky financial transactions from occurring? What Pecora ultimately understood and accepted was that boom and bust periods were inevitable under the capitalist model in the

⁹⁷ *Hearings*, 2115.

⁹⁸ *Hearings*, 2115.

United States, but that certain measures could be taken to ensure that people had all available prior warning of an impending bust. The only way to do this was to close the information gap between the two parties of a financial transaction.

An information divide between bankers and customers allowed National City to market Peruvian bonds to the public without any mention of City's previous concerns. National City participated in the first offering of Peruvian bonds in 1927, a \$15 million offering that National City was able to sell almost immediately. National City marketed Peruvian bonds to its customers throughout the United States, releasing an investment prospectus that assured investors that all the facts that justified National City's confidence in the bonds were available to the public. The profitable nature of the offering led National City to participate in future offerings of \$50 million and \$25 million, even as its internal investigations found that National City should have "no great faith in any material betterment of Peru's economic condition in the near future."⁹⁹ The disconnect between National City's public statements and internal findings concerning the Peruvian bond offering highlighted the problems caused by a lack of regulation over the securities industry. National City's only incentive was to sell the bonds and earn a commission on each sale, without having to actually hold the bonds themselves.

The risky nature of the Peruvian bonds was brought to light by a series of events beginning with the market crash of 1929. The Crash led to the United States Congress passing the Smoot-Hawley Tariff, which effectively closed off the United States from international trade. This decision cratered the economies of South American nations, which were dependent on US consumers. In Peru, the economic disaster led to a

⁹⁹ *Hearings*, 2071.

revolutionary coup in 1930 that deposed President Leguia, the man who had negotiated the bond offerings with National City. The subsequent government of Peru defaulted on its debts, effectively destroying the value of the Peruvian bonds. By 1933, the \$50 million bond offering which National City had sold to its investors at \$91.50 per bond was valued at roughly \$4 per bond.¹⁰⁰ While the events that led to Peru's default were not inevitable when National City began to underwrite Peruvian securities, its own findings had shown the risky nature of investing in Peru.

As Pecora outlined these details to the senators and spectators in Room 301, a silent Charles Mitchell stewed in his chair while Hugh Baker, the deposed former president of National City Company, attempted to explain the reasons behind the Company's decision to market the risky bonds so aggressively. It wasn't until testimony weeks later that Baker ultimately admitted that, in the case of Peruvian bond fiasco, "it would have been better if the whole story perhaps were included."¹⁰¹

The need for "the whole story" to be included in investment prospectuses was obvious after Pecora's questioning of National City Bank and Company executives, revealing yet another way in which Wall Street bankers had misled the public in search of ever greater profits. Pecora's revelations concerning the lengths Mitchell and company had gone to hide the internal knowledge of National City Bank from both shareholders and clients necessitated a change in the operations of Wall Street. Bankers could not maintain that investors ultimately had to be liable for their own financial decisions when bankers were deliberately misleading investors. Pecora was aware of the impact of the

¹⁰⁰ M. R. Werner, *Privileged Characters*, New York: Robert M. McBride & Company, 1935. 463.

¹⁰¹ *Hearings*, 2067-68.

revelations already exposed, but he needed to shift direction after Mitchell and Baker's testimony to prove that the actions of National City bankers were not unique on Wall Street.

It is also important to ask whether the work of Pecora in castigating National City was part of a larger, essentially conservative attempt to perpetuate the status quo on the part of the Roosevelt administration, as has been charged by liberal revisionist historians.¹⁰² The cross-examination of Charles Mitchell demonstrates that this is not the case, that both Pecora and senators on the left and right doggedly pursued lines of questioning that revealed areas ripe for reform. Ranging from the structure of financial institutions to the ways in which information was handled, the Commission did identify ways to change the financial industry for the better. While these changes did not totally remove the possibility of fraud within financial circles, it did establish a framework that allowed banks to continue to perform the lending services that a modern economy relied upon. While the Commission is certainly guilty of operating within the confines of free-market capitalism, such a charge only further legitimizes the work of Pecora and company. The system they helped correct would go on to fund the American century. Reform, not revolution, was the correct course.

¹⁰² Barton J. Bernstein, *Towards a New Past; Dissenting Essays in American History*, New York: Pantheon, 1968, 264.

Chapter 3: The Nail in the Coffin

*“I do not look upon these United States as a finished product.”
-Franklin Roosevelt*

The Fallout

With his powerful questioning and indignant refusal to accept evasive answers, Ferdinand Pecora made himself a progressive hero during the National City testimonies. Despite that, Pecora needed to assemble more evidence if he intended on making a lasting impact on the regulatory regime that oversaw the financial industry. The primary question facing Pecora as he prepared his next move was how to take advantage of the momentum created by the successful cross-examination of the National City bankers. The downfall of Mitchell and his fellow cronies at the top of National City Bank had brought immediate legitimacy to the Commission, bringing the Senate investigation to the forefront of the debate over the causes of the Wall Street Crash and ensuing Great Depression.¹⁰³ Equally important, Pecora’s apparent understanding of financial terminology and use of demonstrable facts to show fraud meant allegations of a witch-hunt style investigation were more difficult to prove.

To make sure that the gains made on both Capitol Hill were solidified, Pecora needed to demonstrate that fraud on Wall Street was not limited to a small group of people within one institution. J.P. Morgan had previously stated, “Any power which he [a banker] has comes...from the confidence of people in his character and credit.”¹⁰⁴ Pecora needed to demonstrate that the power of the country’s major financial institutions was based on a false confidence in the character and credit of the men at the helm of the

¹⁰³ Ferdinand Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, New York: Simon and Schuster, 1939, 83.

¹⁰⁴ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 5-6.

country's biggest banks. Mitchell's testimony had destroyed any trust in the operations of National City Bank, but Pecora had to connect the fraud at National City to a larger cancer that afflicted the entire banking system. Only then could he call for a re-evaluation of trust in the entire banking system.

Pecora's Next Move

Pecora needed to determine what strategy could best take advantage of both the Commission's newfound influence and the populist outcry caused by the National City testimonies. Pecora's political background as a progressive and member of the Democratic Party drove him to continue his aggressive approach to the investigation, allowing his own political beliefs to imbue him with a sense of purpose in his mission to defeat Wall Street. Pecora viewed the Commission as a contest between progressive forces and Wall Street.¹⁰⁵ Luckily for Pecora, the increasing unpopularity of Herbert Hoover and the election of Franklin Roosevelt meant that the progressive ideals Pecora cherished were benefitting from a shift in the political climate of Washington.

As a presidential candidate, Roosevelt had repeatedly called for increased financial regulation, encouraging the Senate to go beyond Hoover's mandate and expand the investigation beyond short selling. Roosevelt's success in connecting with the general American public, as reflected by his substantial victory over Herbert Hoover in the November 1932 election, signaled the final death knell of the laissez faire Republican Consensus that dominated Washington throughout the 1920's. With the tacit support of the President-elect, Pecora no longer had to worry about over-stepping the boundaries set

¹⁰⁵ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, x-xi, (introduction).

by President Hoover, and found himself free to pursue the most aggressive strategy possible to prove his case against Wall Street.

In truth, Pecora was able to use over-aggressively tactics that could be construed as little more than personal attacks due to the political climate in which he was operating. The American public had little sympathy for Wall Street, and the newly elected President did not have any of the reservations that Hoover had in relation to an investigation of Wall Street. The electoral developments of late 1932 freed Pecora from any limitations placed on him by Republican control of the Commission, and his use of personal politics to chastise bankers was a symptom of a desire to skewer not only Wall Street in general, but also the men who worked therein particular. Pecora's newfound confidence and political support encouraged him to approach the investigation with even greater vigor as he decided which witness should be called to testify next.

Pecora decided to take a calculated risk and call Richard Whitney, Chairman of the New York Stock Exchange, to testify before the Commission for a second time. Whitney's original testimony had been a disaster for Senator Norbeck, leading to allegations that the Senate investigation of Wall Street was little more than an inquisitorial attempt to scapegoat a few figures for the demise of the entire banking system. Whitney breezed through his initial testimony, making a mockery of the hapless senators who could match neither his financial acumen nor his easy unflappability.¹⁰⁶ Whitney's laudable performance during his first testimony lent credence to the white-knight reputation he actively cultivated, originally established after he represented a

¹⁰⁶ Michael A. Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, New York: Penguin, 2010, 52.

consortium of major banks that bought massive amounts of stock during the Great Crash in a failed attempt to stabilize markets.¹⁰⁷

Whitney's public image was buffeted by his finely tuned sense of public opinion, as he had shifted his views on financial regulation immediately following Charles Mitchell's testimony. Whitney began pushing the idea that "ephemeral prophets" had been the reason behind the creation of the investment bubble that had precipitated the Great Crash.¹⁰⁸ Whitney was clearly referencing "Sunshine" Charles Mitchell, whose career had been built on a sunny optimism that depended on ever-rising stock prices. Whitney's shift in opinion allowed him to maintain that the bad actions of a few did not warrant the persecution of an entire industry. It was Pecora's job to prove Whitney wrong.

Whitney and the Honor System

Whitney's particular eagerness to pin all the blame for the Great Crash on a few individuals stemmed from the fact that Whitney did not represent any shareholders or banks. Instead, his position as chairman of the New York Stock Exchange made him the public face of the financial community in general. His primary interest was preserving the reputation of the industry, even if that meant offering up an institution as influential as National City as a sacrificial lamb. Whitney also needed to contend with the near total collapse of the securities industry since the Great Crash, as the volume of sales on the New York Stock Exchange had plummeted from a high of 1.125 billion shares in 1929 to just .425 billion in 1932. New securities issuances, another indicator of the health of the

¹⁰⁷ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 49.

¹⁰⁸ "Whitney Proposes Corporation Curbs," *The New York Times* 1 Mar. 1933.

country's stock exchanges, had seen a similar decline, going from \$8 billion in 1929 to \$325 million in 1932.¹⁰⁹ Whitney's testimony was a golden opportunity for him to call on American individuals and companies to look once again to the country's stock exchanges as a place to invest and raise capital.

Whitney's desire to save the industry from being castigated on Capitol Hill was also driven by a more personal need to salvage the reputation of a profession that had enriched his family for generations. The patrician son of a bank president, Whitney had attended the best private schools in the country before ascended to his place at the top of the American financial system. The idea that the Great Crash was the product of institutional fraud on Wall Street was a direct challenge to the Whitney family legacy.¹¹⁰

Whitney adept understanding of public relations also led to him calling for greater disclosure from banks in the case of securities issuance, another clear reference to the problems that Pecora had identified during his questioning of National City executives. Yet Whitney's efforts to disassociate the larger financial community from National City Bank were disingenuous, as every major financial institution benefitted from National City's success in convincing ordinary Americans to try their luck at investing. While National City Company had been a pioneer in exposing greater numbers of Americans to securities markets, they were followed by many other financial institutions hoping to gain a piece of the profits that a broader client base guaranteed. Whitney was using the same strategy that National City had successfully implemented until the testimony of Charles

¹⁰⁹ Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams, Louis D. Brandeis, James M. Landis, Alfred E. Kahn*, Cambridge, MA: Belknap of Harvard UP, 1984, 169.

¹¹⁰ Perino, *The Hellhound of Wall Street: How Ferdinand Pecora's Investigation of the Great Crash Forever Changed American Finance*, 48.

Mitchell, framing the debate over the causes of the market crash and ensuing depression in a way that deflecting blame from financiers in general onto a few rogue players. Just as Mitchell blamed short sellers for the market crash, Whitney tried to make Mitchell the scapegoat for the financial crisis.

Whitney's attempt to shift blame onto one institution was met with extreme skepticism by Pecora, who identified Whitney as a prime candidate to rile up populist anger at Wall Street. Whitney obliged Pecora on the day before his testimony, losing his silver tongue and blaming the American public for the financial panic of 1929, remarking that the public gave its "confidence too readily" to supposed financial experts and business executives.¹¹¹ When Whitney failed to mention that the stock exchange of which he was chairman could not operate without an implicit trust in the managers of the companies listed, Pecora decided to press Whitney on a series of connected issues that his remarks, as well as Mitchell's testimony, had raised.

First, was the lure of short-term profits too great for bankers to ignore? Particularly in the field of securities issuance, banks benefitted from selling the shares or bonds of corporations and governments to investors regardless of the ultimate ability of those institutions to repay the securities. Bankers argued that the problem solved itself, as the relationship between banks and investors would disintegrate without an implicit trust that banks were selling securities at their true value. As J.P. Morgan said, any power a banker had was derived from a faith in his character and credit.

The debate crystallized the different perspectives on regulation and government involvement that were brought to the forefront by the Commission. Pecora and his fellow

¹¹¹ "Whitney Proposes Corporation Curbs," *The New York Times* 1 Mar. 1933.

progressives were more willing to err on the side of caution by insisting that safeguards be put in place to prevent securities fraud and hold individuals accountable for their actions. Whitney and fellow financiers felt government involvement would inhibit the ability of institutions to gain access to capital markets as well as damage competition. Bankers also claimed that they could not be held responsible for the future financial performance of institutions that used their services to gain access to capital markets. In the eyes of Whitney and his supporters, Pecora was calling for the impossible—laws that would regulate risk out of the financial system. A policy of short-term profits at the expense of long-term financial growth was a risk some banks were willing to take, and they had to face the consequences.

Yet the consequences of such a strategy brought up another question that struck deeper into the heart of the American financial system. Could private citizens be trusted with the stewardship of a vital aspect of the national economy without intensive oversight? While the era of too big to fail banks did not yet exist, the Great Depression was clearly related to the chaos caused by the Great Crash on Wall Street in October 1929. The performance of the nation's financial industry had implications far beyond the stock prices of individual banks, as the financialization of the American economy meant that companies across a variety of industries relied on Wall Street on a daily basis.

Whether Pecora and the senators questioning Richard Whitney liked it or not, Whitney represented a class of Americans who held an out-sized influence over the direction of the American economy. Did this mean that special rules should be created to govern such an influential industry? In the eyes of the financial community, their influence was the product of decades of hard work. The scorn being heaped on bankers

and financial institutions was not due to fundamental problems with the financial industry, but rather due to the over-eagerness of businesses and investors to rely on debt to fund growth and investment. Whitney seemed to indicate that financiers were glorified middlemen, directing capital from the vaults of commercial banks to a wide variety of industries, with the goal of spurring growth that benefitted all Americans.

Despite Whitney's insistence that the financial community could handle the entire process of saving and investment, he was never able to sufficiently demonstrate that safeguards had been put in place to combat the fraud that had gone on during the 1920's. Pecora seized on this opportunity, pushing to show that, while the financial industry should not be disregarded or completely retooled, it did require serious oversight to protect bankers from themselves and the rest of the country from the inevitable blowback of deceit on Wall Street. Pecora finally identified a way to poke a hole in Whitney's serene façade when he ceased to question the financial industry on a macro-level and focused on the smaller, more localized question of how the New York Stock Exchange determined the truthfulness of statements issued by companies listed on the Exchange. Did the NYSE do *anything* to confirm the statements of companies or simply operate on a system of implicit trust?

An exchange between Pecora and Whitney at the start of Whitney's testimony speaks to the different perception of the NYSE's role in securities markets held by the two men. While Whitney viewed the exchange as a market that brought two economic actors together, Pecora felt that the Exchange had a larger responsibility to ensure that individual investors were not at a disadvantage due to an asymmetrical information system.

Mr. Whitney: We seek to find out that they (companies applying for listing) have actual plant and earning capacity or both, and when they present their applications for listing they are accompanied by accountants' or auditors' statements from the company itself. Those are reviewed for the facts to be found out, as stated in this memorandum which is in the record.

Mr. Pecora: Then, accompanying the application for listing of a stock there must be a financial statement?

Mr. Whitney: Yes, sir.

Mr. Pecora: Made by the corporation seeking to have its securities listed?

Mr. Whitney: Yes, sir.

Mr. Pecora: That financial statement is analyzed by the members of your stock list committee?

Mr. Whitney: By the employees of the stock list committee; yes,

Mr. Pecora: But no independent audit is made by the stock exchange itself?

Mr. Whitney: Of the company itself?

Mr. Pecora: Yes.

Mr. Whitney: No, sir. We are demanding now

Mr. Pecora (interposing): That never has been a requirement of the exchange, has it?

Mr. Whitney: Yes, sir.

Mr. Pecora: What, to make an independent audit?

Mr. Whitney: A requirement of the Exchange is that an independent audit be made and submitted to us. That has been in force

Mr. Pecora (interposing): I say it never has been a requirement or rule of the exchange for it to make an independent audit or cause one to be made in its behalf. Is that correct?

Mr. Whitney: May I answer?

Mr. Pecora: Yes, sir.

Mr. Whitney: It is not a requirement of the exchange that the Exchange itself will make an independent audit.¹¹²

More than anything, the palpable tension between the two men dominates the cross-examination, as Pecora repeatedly interrupted Whitney in an attempt to direct the course of the testimony. While Whitney's first testimony was a walk in the park for the financier, Pecora's bulldog style ensured that Whitney would not have such an easy time during his second appearance before the Commission. The exchange demonstrates the way in which Pecora would attempt to unsettle the person testifying by constantly interjecting. While such tactics come across as unseemly, they were effective in preventing witnesses from dominating the testimony and allowing Pecora to set the tone for the entire investigation. The image of the immigrant lawyer badgering the blue-blooded financier in an age of open racism towards Italians further underscores the unique approach of Pecora.

Beyond demonstrating Pecora's prosecutorial style, the exchange shows how the NYSE operated on a system of trust that Pecora found very troubling. Whitney and his

¹¹² *Hearings before the Committee on Banking and Currency Pursuant to S.Res. 84 and S.Res. 56 and S.Res. 97. : 1932 - 1934 (1934), 2207.*

colleagues felt it was not their job to independently affirm the financial statements of listed companies; Pecora viewed an approach of blissful ignorance as an abdication of responsibility. Ultimately, the question revolved around an issue that was at the center of many discussions raised during the Commission. Could people be trusted when the opportunity to make money was involved?

The question of implicit trust placed Whitney in the uncomfortable position of maintaining that the New York Stock Exchange was a trustworthy institution, but that fraudulent behavior by some companies was inevitable. Pecora refused to accept Whitney's assertion that fraud was inevitable, directly asking Whitney "whether or not the exchange takes any action seeking to check the statements made to it by corporation officers."¹¹³ Whitney responded that the exchange had to operate under the principle "that people are honest until they are proved otherwise."¹¹⁴ Whitney's answer allowed Pecora to firmly establish that the self-regulatory policies of the country's major stock exchange amounted to little more than an honor system.

The American people needed no reminder that the actions of Charles Mitchell and the country's leading bank had more than demonstrated that an honor system was of little use in an environment where misleading the public led to bigger profits. Just as he had in the case of Mitchell, Pecora finally got the better of his witness when he ceased his attempts to prosecute the entire financial system and instead identified small instances that revealed much larger truths about the ways in which the country's financial system operated.

¹¹³ *Hearings*, 2248.

¹¹⁴ *Hearings*, 2248.

The self-evident ineffectiveness of the New York Stock Exchange's self-regulatory policies led to a final question from Pecora that encapsulated the primary problem he had identified throughout his questioning of both Charles Mitchell and Richard Whitney; was the Exchange that was crucial to the operation of securities markets in America "subject to no official regulatory power?"¹¹⁵ Whitney's answer of no led to an obvious follow-up question that Pecora seemed to pose not only to Whitney, but also to the American people in general—why not?

The Rise and Fall of Albert Wiggin

Following the testimony of Mitchell and Whitney, Pecora had established beyond any reasonable doubt that the risk management structures of both banks and stock exchanges had significant problems. Arguably, Pecora had achieved his goal of demonstrating to the American people that serious changes were needed to the financial system to address some of the root problems that had contributed to the Great Crash of 1929. Still, Pecora needed to disprove the charge that the entire system should not be changed over the lamentable action of a few bad men. To do this, Pecora called to the stand the recently retired Chairman and President of Chase National Bank (Chase), Albert H. Wiggin.

By 1933, Chase was the second largest bank in the country and had managed to retain a reputation for being an "important and leading financial institution" according to Ferdinand Pecora.¹¹⁶ The man who had overseen the management of this sprawling, influential, and well-regarded institution was Albert Wiggin. Wiggin had effectively controlled the entire bank during a period of tremendous growth in terms of both size and

¹¹⁵ *Hearings*, 2248.

¹¹⁶ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 131.

influence. When Wiggin joined the bank in 1904, Chase was a privately held concern with only 20 shareholders and a little over \$54 million in total deposits. By the time of Wiggin's retirement in 1932, Chase had over 89,000 shareholders, deposits of roughly \$2 billion, and branches in every corner of the globe. As Wiggin himself said when asked to describe the ubiquitousness of Chase during his testimony, Chase "is known in every town in the country, and in a great deal of the rest of the world."¹¹⁷

Wiggin further maintained, in noticeable contrast to Charles Mitchell and National City, that Chase had embraced its status as an organization of national significance, writing in a letter to shareholders that Chase was "an institution whose public service is commensurate with its magnitude."¹¹⁸ Wiggin watched closely as the bankers who had previously testified before the Commission had been pilloried for excessive selfishness, and worked hard to create the impression that Chase existed not only to serve its shareholders, but the country at-large. Wiggin realized that the public was in no mood for a lecture about management's actual responsibility, to generate profits for shareholders above and beyond everything else. In many ways, Wiggin seemed to latch onto the same narrative that Pecora had been attempting to develop throughout the Commission's investigation; the financial industry was unique in its size and impact on the broader national economy. Pecora's solution was to create a regulatory regime that would work to prevent such an influential industry from crashing as spectacularly as it had in 1929. Wiggin felt his career at Chase was proof that banks were perfectly capable of recognizing their importance and acting in a way that aligned their dual interest in profits and good citizenship. The debate that went on between Wiggin and

¹¹⁷ *Hearings*, 2281.

¹¹⁸ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 132.

Pecora during the former's testimony would ultimately decide whose vision would triumph.

The Rockefeller Bank

Although his efforts to grow Chase into an international financial institution organically made Wiggin highly respected throughout the financial world, it was his work in 1930 to merge Chase National Bank with the Equitable Trust Company that was the crowning achievement of his career.¹¹⁹ The Equitable Trust Company was the entity created by the Rockefeller family to manage their wide variety of assets and holdings, and the merger made Chase become, in the eyes of the world, the Rockefeller Bank. In a time of intense uncertainty and fear about the world financial system, Wiggin had tied Chase to the greatest fortune in American history. Such a spectacular merger, and with it the end to any speculation that Chase was threatened by the daily financial turmoil created the Great Depression, led the National Banking Examiners to declare at his retirement that Albert Wiggin was “the most popular banker on Wall Street.”¹²⁰ Not stopping with its adulation of Wiggin and his work on Wall Street, the NBE further declared, “The national banking system has no greater standard bearer than the Chase National Bank.”¹²¹ In total, Albert Wiggin had built an institution that was envy of the financial industry. Pecora was determined to find out if this sterling reputation was deserved.

Pecora had reason to wonder if cracks might exist in the seemingly impenetrable armor of Wiggin, as by 1933 Chase was quickly distancing itself from Wiggin's tenure.

¹¹⁹ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 132.

¹²⁰ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 134.

¹²¹ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 134.

Wiggin's successor as Chairman and President of Chase was Winthrop Aldrich, the brother-in-law of John D. Rockefeller Jr. and son of the powerful former Senator Nelson Aldrich. Winthrop Aldrich quickly realized that public opinion of Wall Street's actions during the 1920's was becoming increasingly negative, and released a statement shortly before Wiggin's testimony that called for a complete divorce of commercial banking and investment banking, and the eradication from the management of commercial banks of the "spirit of speculation."¹²²

It was a statement Pecora might have written himself. Aldrich's criticisms applied to Wiggin's tenure at Chase as much as Mitchell's at National City, and it was a clear attempt to dissociate Aldrich's rule at Chase from the excesses of the Roaring 20's. The influence of Pecora's investigation on Aldrich's statement was evident; a man who had been lauded as the most popular banker on Wall Street in 1932 was being hung out to dry by the bank he had built less than twelve months later. As Pecora began his cross-examination of Wiggin, he was confident that Aldrich's press release had been a pre-emptive move to distance Chase from the allegations that would inevitable come out during the course of Wiggin's testimony. The only thing left for Pecora to do was ask the right questions and let the former Wall Street chieftain dig his own grave. As Pecora quickly realized, Wiggin was more than happy to oblige.

History Repeats Itself

Pecora began his cross-examination by focusing on the topic that Aldrich had himself mentioned when he sought to distance himself from Wiggin's reign at Chase. Just as Mitchell had done at National City, Wiggin had ignored rules prohibiting commercial

¹²² Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 140.

and investment banks from co-existing within one financial institution. Pecora revealed that Chase had outdone even National City in using legal loopholes to create a web of inter-related investment affiliates. Whereas National City Bank had been content to organize only one investment affiliate, Chase had actually created five separate investment companies to take advantage of lucrative securities markets, the largest of which was the Chase Securities Corporation.

Pecora seized on the similarities between National City and Chase's structures by asking Wiggin if "the Chase Securities Corporation (CSC) was organized as an affiliate of the Chase National Bank in such a fashion that the identity of the stockholders of the CSC was the same as the stockholders of the Chase National Bank?"¹²³ Wiggin admitted, "that is correct," showing that Chase was no different than National City in its flouting of existing banking laws.¹²⁴ Just as the public began to doubt Charles Mitchell when he revealed that National City circumvented laws designed to prevent excessive exposure at nationally prominent banks, Wiggin's words guaranteed that he would never extend his popularity on Wall Street to Main Street.

Wiggin's admission that he had organized investment affiliates that ran counter to banking laws was made even worse after the lawyer who helped organize the legal structure of Chase, Eldon Bisbee, was called to testify concerning his role in the creation of the CSC and other investment companies.

Mr. Pecora: In other words, it was considered desirable to have all of the capital stock of the Chase Securities Corporation held at all times by the stockholders of the Chase National Bank?

¹²³ *Hearings*, 2298.

¹²⁴ *Hearings*, 2298.

Mr. Bisbee: That was a part of the unanimous agreement on the part of the stockholders of the bank when the Securities Co. was organized.

Mr. Pecora: Mr. Bisbee, will you tell the committee the reasons for that? What were considered to be the advantages to the institution of such an arrangement?

Mr. Bisbee: I will do my best Mr. Pecora. Perhaps the business reasons might be better explained by someone else; but a bank as such may not engage in the securities business; that is, as the securities business is generally understood. Banks are restricted in the nature and quality of investments that they may make; and it was considered advisable at that time to have a corporation owned by the same stockholders in exactly the same percentages, that might undertake business which the bank could not undertake, and not only thereby make money for the stockholders by undertaking that business but thereby enhance the good will of the bank itself by enlarging the circle of its operations.¹²⁵

In one paragraph, Bisbee illustrated that the investment affiliates created by banks existed purely as a means to flout banking laws and allow commercial banks access to securities markets. Pecora had focused on Chase because he needed to prove that it was not just one bank that acted as if the rules did not apply. Wiggin and Bisbee combined to show that this was indeed the case.

Wiggin managed to exacerbate the damage of the bank structure revelations when he was given the opportunity to share his views on the recent statements of his successor

¹²⁵ *Hearings*, 2288

at Chase concerning the relationship between commercial and investment banks. Asked by Pecora if he agreed with Aldrich's "proposals in principle," a stone-faced Wiggin quickly replied, "No."¹²⁶

Wiggin's refusal to acknowledge that organizing commercial and investment banks under one larger financial institution had contributed to the "spirit of speculation" mentioned by Aldrich demonstrated how out of touch he was with the mood of both Congress and the public. Despite the fallout after Mitchell's revelations, Wiggin refused to admit that he had done anything wrong. His hubris before the Commission was a product of his extraordinary success at the helm of Chase, leading him to believe, like Richard Whitney before him, that the meager minds of the Commission were simply unable to grasp the complexities of the financial system.

Pecora wasted no time proving to Wiggin that he was a man of formidable financial acumen when Pecora dived into the topic of stock pools. Stock pools were an example of financial engineering on Wall Street that managed to further disadvantage the investing public, and were so named because they pooled together the money of individuals or institutions under the control of one manager. In practice, stock pools manipulated market prices by selling a large portion of a company's shares to a pre-arranged buyer with an agreement to buy back the shares at the same price. The practice worked because trading a large enough portion of a company's shares would lead to the overall market responding positively. When the company's share price went above a certain level, the original owner would buy back the stock at the original price and reap profits for free.

¹²⁶ *Hearings*, 2300.

Stock pools, while not technically illegal, were clearly a case of market manipulation by financiers at the expense of the general public. Wall Street was managing to push stock prices up and down on a whim, earning free money while everyone else was left trying to react to irrational movements in share prices. Banks with multiple investment affiliates, such as Chase National Bank, were in the best position to benefit from stock pooling. Chase could order its investment affiliates to trade shares amongst themselves with the ultimate goal of enriching Chase executives. Taken to an extreme level, a bank with enough money and investment affiliates could organize stock pools that could control the entire stock market. Despite Whitney's earlier exhortations about the impact of regulation on competition, a lack of government oversight on Wall Street had led to major banks identifying a way to end competition by organizing massive sums of money and creating multiple companies to trade it amongst themselves.

Chase Securities Corporation specialized in forming stock pools, eventually starting eight stock pools between 1927 and 1931. Each stock pool owned nothing but shares of Chase National Bank, allowing the bankers at CSC to artificially propel Chase's stock price over a four-year period. Chase's stock price rocketed from \$575 a share in 1927 to \$1415 a share in 1929, reflecting the initial success of the stock pools in driving up Chase's stock price and enriching the holders of the stock—mainly Albert Wiggin and his fellow executives at the bank.¹²⁷

Wiggin, in a feat of greed astonishing even on Wall Street, not only pushed his colleagues at Chase to use pooling schemes to benefit Chase, but he also personally took advantage of stock pooling through the creation of multiple shell corporations that

¹²⁷ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 151.

entirely owned his substantial holdings of Chase National Bank stock. Each corporation was under either his control or that of his family, with each company named for the family members that owned it. For instance, a large chunk of Wiggin's Chase holdings were under the ownership of the Shermar Corporation, which was wholly owned by Wiggin's daughter Marjorie and her husband Sherburne.¹²⁸

Pecora presented evidence of the stock pools to an astonished audience, demonstrating the ease with which Chase's executives had enriched themselves simply by trading company stock with prearranged buyers. When confronted with overwhelming evidence of the use of stock pools by CSC, Wiggin denied that the bank was misleading the public by artificially inflating its own stock price. Pecora pressed Wiggin on the pooling practices, asking whether stock pooling "was not scheme for churning the market and producing an activity that would stimulate prices?"¹²⁹ Wiggin's response encapsulated the divide that existed between the titans of Wall Street and the rest of the country, demonstrating how financiers on Wall Street viewed themselves. Wiggin replied that he viewed stock pools as "a God-given market," one that he and his fellow bankers had a responsibility to take advantage of.¹³⁰

Pecora's rebuttal to Wiggin's religious belief in his own right to make free profits was one that would resonate around the country, perfectly capturing the sentiment of incredulity that many felt at the refusal of bankers to admit any wrongdoing. Pecora turned to the crowd in the Senate Office Building and said, "I believe Napoleon said that

¹²⁸ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 148.

¹²⁹ *Hearings*, 2432.

¹³⁰ *Hearings*, 2432.

‘God is on the side that has the heaviest artillery.’ In this case, apparently, He was on the side of Chase Bank and its affiliates.¹³¹”

Pecora gave voice to a feeling that was slowly strengthening with each successive testimony before the Commission. Banks on Wall Street seemed to think that normal rules did not apply to them, that by virtue of their brains and capital accumulation they were entitled to make profits and enrich themselves without compunction. On a very fundamental level, the Pecora Commission revealed that the stock market, where fairness should reign supreme, was a rigged game. Finding a way to fix the problem of unfairness in markets, not discard them altogether, became the guiding force behind Pecora’s questioning.

Having finally identified both an achievable goal as well as the limits of the investigation’s reach, Pecora demonstrated his courtroom skills by showing the ways in which Chase’s stock pooling practice had collapsed under its own illegitimacy. The Great Crash brought an end to the effectiveness of stock pooling, as no amount of insider trading could convince the broader market that Chase’s stock price deserved to go up while the rest of the market plunged. By the time Chase dissolved its stock pool operations, its stock was trading at \$89 per share in terms of 1927 stock (the stock had been split multiple times between 1927 and 1931).¹³² Despite Chase’s best efforts, stock pooling had not prevented Chase’s stock price from losing over 93% of its value from 1929 to 1931.

Pecora had managed to demonstrate that the executives at Chase were no better than their counterparts at National City in their desire to manipulate markets to their

¹³¹ *Hearings*, 2432.

¹³² Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 151.

liking, using fraudulent practices to mislead the public. The final excuse bankers had used to hold off regulation, that problems in the financial industry were not systematic but rather limited to a few bad apples, no longer applied. The country's two largest financial institutions were both rife with corrupt practices, cementing Pecora's case that self-regulation was a policy that simply did not work. Wall Street needed a watchdog.

The Return of the Short-Seller

In a twist of fate that might have led Herbert Hoover to begrudgingly smile, Pecora's investigation, which had examined topics varying from banking structure to financial engineering, finally returned to the subject that had led Hoover to call for a Senate investigation in the first place. Short selling, which enabled investors to profit from a decline in the value of a company's share price, finally reached center stage before the Commission. Yet the man who would personify the immense problems caused by short selling was not some shady investor. As it turned out, the man who profited from short selling more than anyone else during the Great Crash was none other than Albert Wiggin.

Using insider knowledge of the worsening financial situation (which reached its nadir in late October 1929), Wiggin executed a very lucrative trade between September 19, 1929 and December 11, 1929.¹³³ Wiggin shorted the stock of Chase National Bank, of which he was Chairman and President, in the month leading up to the Great Crash, using both his own money and money he borrowed from Chase at no interest. Wiggin made over \$4 million shorting Chase's stock in the final months of 1929, all while publicly

¹³³ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 153.

proclaiming his confidence in the financial health of Chase in particular and America in general.¹³⁴

To make the deception even sweeter, Wiggin used a legal loophole to short Chase stock through a Canadian investment affiliate he controlled, allowing him to avoid paying a dime of tax to the United States government on his \$4 million profit. While Charles Mitchell had also used a clever legal dodge to avoid paying income tax in 1929, he could at least truthfully maintain that he had lost more money than anyone in a hopeless attempt to push up the stock of National City Bank. Wiggin had not only gotten out of paying tax on his tremendous profits, but he did it while lying to the entire country about Chase's financial prospects. In contrast to portrait Herbert Hoover had once painted, Pecora revealed that short sellers were actually operating at the heart of the American financial system, using confidential knowledge and investment acumen to earn outsized profits at the expense of shareholders. For a man once proclaimed to be the most popular banker on Wall Street, Albert Wiggin turned out to be the biggest traitor on the Street.

¹³⁴ Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers*, 153.

Conclusion

*"We are seeking to re-create, rebuild, and restore confidence."
-Joseph P. Kennedy, First Chairman of the SEC*

Wiggin's testimony was the final deathblow to any attempt by Wall Street to argue against the need for much greater regulatory oversight of both banks and the men who ran them. Particularly with Roosevelt firmly ensconced in the White House and Pecora striding up and down the Senate Office Building, financial regulation became inevitable.

The passage of the Securities Act of 1933 separated investment and commercial banks and required banks to release investment prospectuses detailing all information a bank had collected on a certain security before offering it to the public for sale. Also, the Securities and Exchange Commission (SEC) was created in 1934 to act as the official regulator of the financial industry and to ensure that the new laws were being enforced. Pecora was appointed as one of the founding members of the SEC's board, evidence of his success in proving that regulation on Wall Street was a matter of vital importance to the American economy.

The separation of commercial and investment banking sought to prevent the risky nature of the securities industry from seeping into the more stable world of commercial banking. It also prevented the rise of integrated financial institutions that were capable of providing a full range of banking services. Did this create a financial system that was more stable or less efficient? Either side of the argument has merits, but the ultimate consequence of separating commercial banks and investment banks was a system that sacrificed larger potential profits for a level of security that seemed pertinent following the Great Crash and its aftermath. In this case, the Commission was successful in

allowing a capitalist economy to continue functioning by preventing the safety of deposits from being threatened by fluctuations in securities markets.

Such a system prevailed until 1999, when the federal government passed legislation removing the ban on integrated financial institutions. In his memoirs, Ferdinand Pecora warned that, as the country moved farther and farther away from the terrible period following the Great Crash, the need for intense scrutiny of the financial sector would slowly loss out to a desire for ever-growing profits. The financial crisis of 2008-2009, which saw the risky bets made by securities traders backfire, metastasized into the Great Recession in part due to the close connections between the investment and commercial divisions of integrated financial institutions. Had the warnings of Pecora not been lost to the sweep of history, perhaps much of the wealth destruction following the most recent financial crisis could have been avoided.

This possibility raises another question, one that has driven much of the liberal critique of the New Deal as a whole and the Pecora Commission in particular. Did Pecora miss an opportunity to create a banking system immune to financial crises? The answer is one that depends upon America's level of commitment to individual freedom and free-market capitalism. Pecora could have called for a nationalized banking system that would have placed control of the financial industry in the hands of the government. Senator Bronson Cutting, a Republican who served in the Senate at the time of the Pecora Commission, said that the country's banking system could have been nationalized "without a word of protest," in the tumultuous times of the early 1930's, a testament to

the intense economic problems caused by the Great Depression.¹³⁵ Pecora resisted calling for such an action, instead choosing to reform, not throw out, the system that led to the Great Crash. This decision demonstrates that Pecora, for all his populist bluster and Progressive background, pursued a moderate strategy that cannot be easily classified as liberal or conservative.

Pecora's choice to turn away from radical solutions to the country's financial ills does indicate a conservative streak in the fiery investigator, but it also reveals a dedication to the concepts of individual freedom that always remained strong in an immigrant whose family came to the United States to avoid persecution. Risk, the Pecora Commission found, was not the problem with the American financial sector in the 1920's. A lack of information to gauge the level of risk of an investment was the problem, and the requirement for investment houses to release full prospectuses detailing any investment opportunity's background gave investors that ability. Conservative critiques of New Deal banking legislation argue that the solutions discovered by the Commission emasculated individual investors at the hands of cumbersome governmental regulation; in fact, the Securities Act of 1933 was the first instance of individuals being empowered to face Wall Street on an equal plane.

The SEC, crafted to enforce the Securities Act of 1933, remains the most important symbol of the Commission's success, as the agency still exists today as a powerful reminder of the good that reform can do. While it routinely faces charges of incompetence and selective enforcement that financiers warned about in the 1930's, the agency has long been considered an archetype for other governmental regulators. Proof

¹³⁵ Barton J. Bernstein, *Towards a New Past; Dissenting Essays in American History*, New York: Pantheon, 1968, 265.

of its success can be seen in the words of a report commissioned by President Ronald Reagan at the start of his first term, which called the SEC “a model government agency.”¹³⁶ The SEC remains to this day an integral part of America’s financial system because it has the capacity to incentivize sound business practices on Wall Street. As the structures of both Chase National Bank and National City Bank during the 1920’s showed, banks would find a way around government regulation unless laws were supported by a capacity for enforcement. The enforcement aspect of the agency’s mandate brought an end to the policy of self-regulation that allowed Wall Street to give little more than lip service to governmental decrees.

The Pecora Commission found success because it understood that regulation on Wall Street, not an end to Wall Street, was the solution to the nation’s fear of a financial crisis causing a broader economic decline. By limiting its goals to proving that fraud existed, and that certain measures could be put in place to prevent that fraud, the Commission created a precedent in the financial industry that exists to this day in the form of SEC. That the Commission decided to follow this path, instead of options that would have fully satisfied either the left or right, shows how important political considerations were in the development of the regulatory regime that exists today.

An issue that has plagued any effort at viewing the Pecora Commission as a moderate attempt to reform the financial system is the reliance by Pecora on underhanded tactics to prove his points. Throughout the testimony of Richard Whitney, Pecora abandoned respect for the witness in an attempt to verify the lax nature of the internal audit system of the New York Stock Exchange, and Pecora’s use of details from

¹³⁶ SEC Transition Team, “Final Report,” December 22, 1980, I, 9.

Wiggin's personal financial history was a gratuitous attempt at raising the ire of the public. Pecora made a political case for reform on Wall Street, while both the financial industry and America in general would have been much better served by a financial case for reform. By using personal attacks to make his points, Pecora forever opened up the Commission to accusations of scapegoating. Pecora had the resources and ability to show the Commission that the financial evidence before them was sufficient to demand reform. Instead, he fell back on the easier road to reform, that of political pandering.

However, Pecora's usage of populist rhetoric matched the mood of the country in the dark days of 1933, an era which saw deprivations that modern historical observers have trouble comprehending. Even in the midst of a modern financial crisis, unemployment figures don't begin to approach those of the Great Depression, illuminating how ripe the country was for radical changes to the American economic system of the 1930's. Despite his ugly bombast, Pecora resisted fundamentally changing the system that would serve as the world's financial center in the prosperous era following the Second World War. While it is important to note that Pecora's language was that of a radical, it is more important to understand that his words were just that, words. By satiating the public desire for a chastising of Wall Street, he allowed legislators to craft laws that were moderate in nature.

Ferdinand Pecora's immediate success in demonstrating the complete lack of accountability on Wall Street for risky financial strategies reopened the debate over both the causes of the 1929 market crash as well as the steps the government might take to prevent such a crisis from occurring ever again. It was the second debate, concerning the role of the government in financial regulation, which transformed the Pecora Commission

from an arcane investigation of financial practices into a larger examination of the ability of businesses to self-regulate in a free market environment.

The revelations of Charles Mitchell's tax evasion and Albert Wiggin's short selling illustrated that high-level executives would not only look out for their own financial well-being first and foremost, but also that this focus on financial preservation was institutionalized on firm-wide basis. The success of Mitchell and his National City bankers was predicated on a strategy that took advantage of a lack of oversight to create a banking structure that directly contradicted existing federal law. Wiggin and his associates copied this method to power their own success. The combination of investment and commercial banks allowed National City and Chase to push increasingly risky bonds on the American public, safe in the knowledge that the actual value of the bonds had nothing to do with the profits they earned from their sale.

Ferdinand Pecora's questioning of Mitchell and Wiggin brought these facts to light over two years after the market crash of 1929, forcing the American public to face the reality that the so-called experts, who had long maintained that a worse crisis was averted only through their actions, were pursuing morally bankrupt practices. Pecora revealed that the financial industry was structured in such a way that excessive risk was incentivized, because bankers' pay was increasingly tied to the quantity of securities they sold, not the quality of the investments they made. The questions that the testimonies raised struck at the heart of American capitalism; what power did the government hold to regulate privately owned companies? Did securities markets have an inherent risk that posed a continuous threat to the financial stability of the United States?

The Pecora Commission's findings contributed to the development of a financial system that sought to chart the middle way between the two paths the above questions would indicate, balancing liberal demands for fairness and a focus on the greater good with conservative calls for free markets and unfettered individualism. The Commission refused to pursue a radically liberal approach that would have called for nationalization and ignored conservative claims that interpreted any government intervention as too much regulation. The system that emerged following the Pecora Commission and the subsequent legislative acts of Roosevelt's Presidency were conservative in foundation, yet imbued with liberal principles. By contributing to a system that neither left nor right could claim wholly as their own, the Pecora Commission avoided becoming a relic of a single historical age, a Congressional investigation relevant only through the lens of that particular era's politics. Instead, it helped provide the evidence and reasoning that would underpin a system that contributed to the explosive growth of the American economy over the course of the 20th century.

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