Prelude to Glass-Steagall: Abusive Securities Practices by National City Bank and Chase National Bank During the “Roaring Twenties”

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I. INTRODUCTION

From the mid-1990s through 2008, the United States experienced the biggest booms and busts in its securities and housing markets since the “Roaring Twenties” and the Great Depression. Scholars have studied the events that led to the recent financial crisis and have
compared those events to the causes of the Great Depression. Analysts also have analyzed whether “universal banks”—financial conglomerates that control deposit-taking banks as well as securities underwriters and dealers—played pivotal roles in both crises.

John Reed, a former cochairman of Citigroup, recently argued that the United States Congress made a serious mistake when it enacted the Gramm-Leach-Bliley Act in 1999. GLBA repealed the Banking Act of 1933 (Glass-Steagall) and authorized the creation of universal banks that resembled the bank-centered “financial department stores” of the 1920s. In Reed’s view, “the universal banking model is inherently unstable and unworkable” and cannot be made safe by any amount of regulatory reform.


5. John Reed, We Were Wrong About Universal Banking, Fin. Times (Nov. 11, 2015, 3:52 PM), http://www.ft.com/intl/cms/s/0/2551af3e-8872-11e5-90de-f44762b9896.html; see also Wilmarth, supra note 1, at 972-75 (discussing the enactment of GLBA and the demise of Glass-Steagall); infra notes 53-65 and accompanying text (discussing the creation of bank-centered financial department stores during the 1910s and 1920s).

6. Reed, supra note 5. Reed also argued that the “high-risk, high-cost” culture of “investment banking and trading” is “incompatible” with the “risk averse” culture of “traditional banking.” Id. Reed previously apologized in 2009 for his role in arranging the 1998 merger between Travelers Company and Citicorp, which created Citigroup and placed great pressure on Congress to repeal Glass-Steagall. In contrast, Sandy Weill, the other cofounder of Citigroup, at first defended his role in creating Citigroup and in persuading Congress to repeal Glass-Steagall. Arthur E. Wilmarth, Jr., Citigroup: A Case Study in
to reinstate Glass-Steagall’s wall of separation between commercial banks’ and securities firms became major topics of debate among presidential candidates during the early stages of the nomination battles for the 2016 election.\footnote{Managerial and Regulatory Failures, 47 IND. L. REV. 69, 134-35 (2014); see also Wilmarth, supra note 1, at 972-73 (discussing the impact of the Travelers-Citicorp merger in pressuring Congress to repeal Glass-Steagall). However, in 2012, Weill changed his mind. He called for universal banks to “be broken up so that the taxpayer will never be at risk, the depositors won’t be at risk, the leverage of the [commercial] banks will be something reasonable,” and independent securities firms could “make some mistakes” without causing a systemic financial crisis. Kevin Wack, Weill Puts Glass-Steagall Back on Washington’s Agenda, AM. BANKER (July 25, 2012), http://www.americanbanker.com/issues/177_143/sandy-weill-puts-glass-steagall-back-on-washingtons-agenda-1051271-1.html (quoting Weill).}

It therefore seems appropriate to revisit the question of whether Congress had good reasons in 1933 to separate commercial banks from securities firms. This Article is part of a larger project in which I plan to examine the rise and fall of financial department stores in the 1920s and 1930s and to compare their experience with the central role that second-generation universal banks played during the booms and crashes of the 1990s and 2000s.

As I will describe in Part II of this Article, large universal banks became leading underwriters and distributors of securities in the United States during the 1920s. The preeminent universal banks of the 1920s were also the two largest U.S. commercial banks: National City Bank of New York (National City), the predecessor of today’s Citigroup, and Chase National Bank (Chase), one of the predecessors of today’s JPMorgan Chase & Co. National City and Chase established securities affiliates to evade legal restrictions on the securities activities that were permissible for national banks. Both banks and their affiliates created far-flung networks of offices to

\footnote{7. As used in this Article, the term “bank” refers to a commercial bank unless otherwise indicated. The term “securities firm” will generally be used to refer to an investment banking firm.}

facilitate their underwriting and sales of securities in the United States and foreign countries.

National City and Chase earned huge profits from their securities operations during the economic boom of the 1920s, but they suffered massive losses during the Great Depression. Both banks announced in March 1933 that they would shut down their securities affiliates. Both banks also received bailouts from the Reconstruction Finance Corporation (RFC) in December 1933.

As I will discuss in Part III.A, the Great Crash of 1929 and the waves of bank failures between 1930 and 1933 prompted Congress to hold a series of investigative hearings. Those hearings revealed that universal banks used unsound and deceptive practices to sell large volumes of high-risk securities during the 1920s. Universal banks also made ill-advised loans to investors and issuers to promote their underwriting and trading of securities. The sale of speculative securities by universal banks inflicted enormous losses on investors during the Great Depression. Congress responded in June 1933 by passing Glass-Steagall, which mandated a strict separation between the banking industry and the securities markets.

Part III.B provides illustrative examples of the abusive securities practices and conflicts of interest that occurred at National City, Chase, and their securities affiliates during the 1920s and early 1930s. National City and Chase used misleading prospectuses and high-pressure sales techniques to promote the sale of hazardous foreign bonds and other high-risk securities to retail investors (including their depositors) and smaller financial institutions. Both banks made unsound loans to investors and issuers of securities to support the activities of their securities affiliates. Both banks organized trading pools to pump up the prices of their own stocks, as well as the stocks

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of favored clients. Insiders at both banks took advantage of their securities operations to reap extraordinary financial gains. Revelations of securities abuses and insider self-dealing at National City and Chase triggered widespread public outrage and helped to build public support for enactment of Glass-Steagall as well as the Securities Act of 1933\(^\text{10}\) and the Securities Exchange Act of 1934.\(^\text{11}\)

The abuses and conflicts of interest that occurred at National City and Chase illustrate the potential dangers of allowing commercial banks to affiliate with securities underwriters and dealers. The “Pecora hearings” revealed pervasive conflicts of interest that existed across the deposit-taking, lending, underwriting, and trading activities of National City and Chase. The disastrous experiences of National City and Chase during the early 1930s demonstrated the dangers of allowing banks to use their deposits and lending facilities to promote speculative underwriting and trading operations. The near collapse and bailouts of both banks also highlighted the systemic risks that are likely to occur when major banks and the securities markets become tightly linked. Finally, it does not appear to be a coincidence that the emergence of universal banks in the 1920s was associated with an enormous boom in the issuance of unsound and high-risk securities to the public. The misconduct that took place at National City and Chase demonstrated the need for strong laws to protect unsophisticated investors and other consumers against exploitation by powerful financial institutions.

II. NATIONAL CITY AND CHASE BECAME LEADING PARTICIPANTS IN THE SECURITIES MARKETS DURING THE 1920S

During the decade leading up to the stock market crash of 1929, banks greatly expanded their presence in the securities business. As I have described in previous work, both bank loans on securities and bank investments in securities grew rapidly between the end of World War I and 1930.\(^\text{12}\) This Part focuses on the dramatic expansion of securities-underwriting and -distribution activities that occurred at


\(^{12}\) See Wilmarth, supra note 9, at 569-70 (stating that bank loans on securities rose from $5.2 billion to $13 billion between 1919 and 1930, while bank investments in securities grew from $8.4 billion to $13.7 billion between 1921 and 1930).
The large-scale entry of banks into the securities-underwriting business in the 1920s marked the final stage in the emergence of universal banks (frequently called “financial department stores”) in the United States. As described below, national banks organized securities affiliates in the early 1900s to circumvent legal restrictions on their authorized securities activities. Banks played a major role during World War I in selling war bonds issued by the Allies and the United States. The great success of the war bond sales and favorable economic conditions during the 1920s encouraged universal banks to expand their securities operations aggressively after the war ended. National City and Chase led that movement.

A. National City, Chase, and Other Large Banks Organized Securities Affiliates To Evade Legal Restrictions on Their Securities Activities

The National Bank Act of 1864 authorized national banks to buy and sell federal government bonds, but it did not specifically authorize other types of securities activities. During the late nineteenth century, the Comptroller of the Currency (Comptroller), the regulator for national banks, permitted national banks to establish bond departments. With the Comptroller’s acquiescence, national banks used their bond departments to compete with state-chartered banks and trust companies in buying and selling bonds issued by state and local governments and corporations.

Several court decisions and a 1902 opinion by the Comptroller determined that the National Bank Act of 1864 did not allow national banks to invest in equity stocks or to underwrite distributions of debt.
or equity securities.\textsuperscript{16} To evade those rulings, large national banks established state-chartered securities affiliates.\textsuperscript{17} Bank executives used various types of control arrangements (including voting trusts and combined or linked stock certificates) to connect each bank with its sponsored securities affiliate. Those arrangements ensured that (1) shares of the bank’s stock would be purchased, sold, or transferred together with shares of its affiliate’s stock and (2) the bank’s senior management would maintain control over both the bank and its affiliate.\textsuperscript{18}

In 1911, National City established National City Co. (NCC) as its securities affiliate. Attorney General Charles Wickersham challenged the legality of NCC and obtained a supporting legal opinion from Solicitor General Frederick Lehmann.\textsuperscript{19} Lehmann’s opinion determined that National City’s affiliation with NCC would violate the National Bank Act of 1864 by involving National City “in business and ventures beyond its corporate powers.”\textsuperscript{20} Lehmann focused in particular on the complete control that National City’s officers and directors would possess over NCC, as well as the large stock positions that NCC owned in sixteen other banks. Lehmann concluded that NCC’s ownership of bank stocks contravened an 1899 United States Supreme Court decision, which declared that a national bank could not own the stock of any other bank.\textsuperscript{21}

Lehmann expressed further concerns about the broader implications of National City’s affiliation with NCC. Lehmann warned that NCC’s securities activities would encourage the

\begin{itemize}
\item \textsuperscript{16} REDLICH, supra note 14, at 393; Peach, supra note 9, at 483-85, 488-89, 498-99.
\item \textsuperscript{17} Beginning in 1903, national banks organized state banks or trust companies to serve as securities affiliates. In 1908, the First National Bank of New York organized the first nonbank securities affiliate. REDLICH, supra note 14, at 393; Peach, supra note 9, at 491-94, 499-501.
\item \textsuperscript{18} CAROSSO, supra note 9, at 97-98, 271-72; REDLICH, supra note 14, at 393-94; Peach, supra note 9, at 489-91, 499-506.
\item \textsuperscript{19} CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 66; PERINO, supra note 9, at 203-05; Peach, supra note 9, at 581-83.
\item \textsuperscript{20} Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 239 Before a Subcomm. of the S. Comm. on Banking & Currency, 72d Cong. 2040 (1933) [hereinafter Senate National City Hearings] (opinion of Frederick W. Lehmann, Solicitor General of the United States); accord id. at 2030-42; see also Peach, supra note 9, at 581-83 (discussing Lehmann’s opinion).
\item \textsuperscript{21} Senate National City Hearings, supra note 20, at 2034-35 (opinion of Frederick W. Lehmann) (discussing Concord First Nat’l Bank v. Hawkins, 174 U.S. 364 (1899)); id. at 2037-41 (analyzing the joint control that National City’s officers and directors would exercise over National City and NCC, as well as NCC’s ownership of stock in sixteen banks); see also CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 64 tbl.4.1 (listing NCC’s ownership of stock in fifteen U.S. banks and one foreign bank).
\end{itemize}
“speculative use” of National City’s funds to support NCC’s clients, with resulting “peril” to National City. Additionally, he argued, the precedent established by NCC’s affiliation with National City would allow “many enterprises and many banks [to be] brought and bound together,” with the consequence that “the failure of one may involve all in a common disaster.”

Lehman’s warnings were prescient; they anticipated the debacle that occurred at National City and NCC during the Great Depression.

Secretary of the Treasury Franklin MacVeagh and Secretary of State Philander Knox opposed the views of Wickersham and Lehmann and supported NCC’s validity. MacVeagh asserted that National City’s establishment of NCC as a separate affiliate “complied with the letter of the law.” MacVeagh also endorsed the creation of securities affiliates because they enabled national banks to compete for securities business “with state banks and trust companies,” which possessed broader security powers. MacVeagh wanted to keep “a large part of the banking system within [the United States Department of the Treasury’s] jurisdiction” by establishing a more level playing field between national and state banks.

After considering the conflicting opinions expressed by the United States Departments of Justice, the Treasury, and State, President William Howard Taft decided not to pursue any legal challenge against NCC. To encourage that outcome, NCC voluntarily sold its portfolio of domestic bank stocks. NCC thereafter focused its business on underwriting and trading in securities issued by governments and nonbank corporations.

In 1916, NCC acquired N.W. Halsey & Co. (Halsey), a prominent securities firm with retail brokerage offices in major cities across the nation. At the same time, NCC took over the activities of National City’s bond department. In a public advertisement, NCC proclaimed that its acquisition of Halsey’s operations and National City’s bond department would enable NCC to provide “a superior investment

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22. Senate National City Hearings, supra note 20, at 2042 (opinion of Frederick W. Lehmann).
23. CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 62-63, 66; PERINO, supra note 9, at 205-06.
25. PERINO, supra note 9, at 206.
27. CARROSSO, supra note 9, at 98, 274; CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 66-67; Peach, supra note 9, at 584-86.
service” by virtue of its “[a]mple resources” and “[e]xperienced management,” as well as its “intimate knowledge of the condition of business enterprise and the requirements of investors throughout the country.”

Chase followed National City’s example in 1917, when Chase organized its own securities affiliate, Chase Securities Corporation (CSC). In 1930, CSC greatly expanded the scope of its operations by acquiring the domestic and international securities operations of Harris, Forbes & Co. (Harris Forbes). Other large national and state banks pursued similar strategies. By 1929, more than 130 banks controlled securities affiliates, while more than 350 other banks conducted securities activities through bond departments.

B. National City, Chase, and Other Universal Banks Expanded Their Securities Activities During and After World War I

1. The Sale of War Bonds Provided a Training Ground for Universal Banks

Between 1914 and 1917, U.S. securities firms and commercial banks formed nationwide syndicates to sell $2.5 billion worth of bonds issued by the Allied powers (primarily Great Britain and France). The campaigns to sell Allied war bonds represented a “sea change in the scale of U.S. investment banking” and encouraged securities firms and banks to increase their capacity to market and sell securities to the general public.

National City’s success in selling Allied war bonds persuaded the bank’s senior management that NCC must expand its “placing power” because “broader distribution held the key to [NCC’s] continued success as an underwriter.”

After the United States entered World War I in 1917, U.S. banks and securities firms quickly shifted from selling Allied bonds to supporting the federal government’s efforts to finance the war. The Treasury Department launched massive campaigns to sell four issues of “Liberty Loans” in 1917 and 1918, followed by a “Victory Loan” in

29. Peach, supra note 9, at 525-26 (quoting NCC’s advertisement in the Commercial and Financial Chronicle on October 14, 1916).
30. Id. at 501-02.
31. Id. at 505-06, 535.
32. CAROSSO, supra note 9, at 274-79; Peach, supra note 9, at 499-507, 520-21, 521 tbl.1.
33. CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 86.
34. Id.; see also CAROSSO, supra note 9, at 204-09, 211-12, 216-17, 221 (describing sales of Allied bonds by U.S. securities firms and banks between 1914 and 1917).
35. CAROSSO, supra note 9, at 224-27.
1919 that was designed to “finish the job” and “bring the boys home.” The “Liberty Bond” drives represented an “unprecedented” call on the savings of ordinary citizens. To promote the sale of Liberty Bonds, the Treasury Department organized an elaborate “propaganda campaign,” which “perfected all of the techniques now associated with modern advertising” and featured patriotic rallies, parades, and speeches by prominent celebrities and business leaders.

The government encouraged ordinary citizens to buy Liberty Bonds on installment plans or to buy “war savings stamps” that could be bundled together and converted into bonds. More than twenty million Americans purchased Liberty Bonds and war savings stamps. The experience of owning Liberty Bonds persuaded many Americans that “money could be made by the simple process of holding paper securities until they went up in value.”

Commercial banks eagerly participated in the Liberty Bond drives and sold more than half of the $21.5 billion of Liberty Bonds that were issued between 1917 and 1919. Banks received no commissions or other payments, but they gained many practical benefits from their work on the Liberty Bond campaigns. Banks became familiar “not only with the use of high-pressure selling techniques but also with a tremendous number of new potential buyers of securities.” Most importantly, banks “won [the] confidence” of ordinary citizens.

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37. Carosso, supra note 9, at 224.
38. Sutch, supra note 36, at 16.
39. Id. at 16-21 (explaining that the Treasury Department recruited actors Charlie Chaplin, Douglas Fairbanks, and Mary Pickford; aviatrix Ruth Law; and 75,000 volunteer speakers to advocate the purchase of Liberty Bonds at patriotic rallies, parades, and other events); see also Lawrence E. Mitchell, The Speculation Economy: How Finance Triumphed Over Industry 251-54 (2007) (describing the Liberty Bond campaigns).
40. Carosso, supra note 9, at 225; see also Sutch, supra note 36, at 13-15 (describing “War Thrift Stamps,” which could be bought for twenty-five cents and bundled together to purchase $50 Liberty Bonds, and noting that small investors who purchased and bundled stamps accounted for half of all Liberty Bond sales).
42. Carosso, supra note 9, at 226 (quoting Benjamin Ginzburg, Wall Street Under the New Deal, 245 N. Am. Rev. 58, 70 (1938)).
43. Peach, supra note 9, at 469-70.
44. Carosso, supra note 9, at 226; see also Cleveland & Huertas with Strauber et al., supra note 15, at 384 n.4 (“What [NCC] learned from the Liberty bond campaigns was the technique of mass marketing.”); Mitchell, supra note 39, at 255 (“The Liberty loan drives provided a graduate education for bankers and securities salesmen.”).
ordinary investors because "they offered bonds of unquestioned soundness."

Charles E. Mitchell was the "aggressive" leader of NCC during World War I, and he became the president of National City in 1921. Mitchell quickly recognized that NCC's sales of Liberty Bonds would encourage millions of households to consider buying other types of bonds from NCC after the war ended. In June 1917, Mitchell declared that the Liberty Bond drives were enlisting "a large, new army of investors in this country who have never heretofore known what it means to own a coupon bond and who may in the future be developed into savers and bond buyers."

In March 1919, Mitchell told a class of National City and NCC trainees that "if we could bring the investment banking house to the people in such a way that they would look upon it as a part and parcel of their everyday life; if, by advertising, we could spread the gospel of thrift and saving and investment; . . . we could then . . . lift this investment banking business to a level it had never reached before." By 1919, NCC had already established branch offices in more than fifty U.S. cities. Mitchell told his recruits that NCC's branches "are already working to make connections with the great new bond-buying public . . . and are preparing to serve the public on a straightforward basis, just as it is served by the United Cigar Stores or Child's Restaurants."

45. Peach, supra note 9, at 471.
46. Id. at 457-58, 525. In 1927, a New York journalist described Mitchell as "a human power plant" and "a tireless worker." Charles McD. Puckette, Wall Street Harkens to C.E. Mitchell, N.Y. TIMES, Feb. 13, 1927, at 12; see also CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 87 (quoting former National City president Frank Vanderlip's observation that Mitchell had "an astonishing capacity to create energy"); MITCHELL, supra note 39, at 245 (stating that Mitchell was "known as the greatest bond salesman of all time").
47. CAROSO, supra note 9, at 228 (quoting Charles E. Mitchell, "Sound Inflation," 20 MAG. WALL STREET 295, 295 (1917)).
48. CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 136 (quoting C.E. Mitchell, Vice President, Nat'l City Bank of N.Y., Lecture to Banking III Class, Training Lecture at National City Bank (Mar. 18, 1919)); see also SELIGMAN, supra note 9, at 24 (explaining that Mitchell "took young men and women, gave them a course of training on the sale of securities, and sent them out to find the investors").
49. CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 136 (quoting Mitchell, supra note 48); see also MITCHELL, supra note 39, at 245 (commenting on Mitchell's lecture).
2. National City and Chase Became the Leading U.S. Universal
Banks During the 1920s

During the great economic boom of the 1920s, commercial banks and
their securities affiliates vastly expanded their involvement in
originating and distributing public issues of bonds and stocks. By the
end of the Roaring Twenties, universal banks had become “the
dominant force” and “by far the most important element in the
investment banking business” in the United States.\(^\text{50}\) In 1927, banks
and their affiliates or bond departments accounted for 22% of
originations and almost 37% of participations in all new bond issues in
the United States.\(^\text{51}\) In 1929 and 1930, banks and their affiliates or
bond departments conducted 45% of originations and more than half
of participations in all new bond issues.\(^\text{52}\)

National City, Chase, and their securities affiliates were the
unquestioned leaders among universal banks. Both banks built
extensive networks of offices for selling securities in the United States
and abroad. By the late 1920s, NCC maintained offices in more than
fifty U.S. cities and several foreign cities.\(^\text{53}\) NCC also posted sales
representatives at thirty-seven of National City’s domestic branches
and many of National City’s ninety-eight international branches, which
were spread across twenty-three countries.\(^\text{54}\) NCC linked its office
network with more than 11,000 miles of private telegraph wire.\(^\text{55}\)

NCC sold about $20 billion of bonds and stocks to the public
prior to 1933, and by 1927, it was “the largest agency in the world for
the distribution of investment securities.”\(^\text{56}\) From 1921 to 1929, NCC
originated or participated in the distribution of $10.73 billion of bonds,
representing more than a fifth of all domestic and foreign bonds sold
in the United States during that period.\(^\text{57}\) NCC was particularly active

\(^{50}\) Carasso, supra note 9, at 279; accord Perkins, supra note 9, at 495.

\(^{51}\) Carasso, supra note 9, at 279.

\(^{52}\) Id.; Peach, supra note 9, at 546-49.

\(^{53}\) Cleveland & Huertas with Strauber et al., supra note 15, at 152-53; Peach,
supra note 9, at 527.

\(^{54}\) Cleveland & Huertas with Strauber et al., supra note 15, at 116, 123, 152-
53; Peach, supra note 9, at 527.

\(^{55}\) Peach, supra note 9, at 527.

\(^{56}\) Id. at 458, 527; accord Senate National City Hearings, supra note 20, at 1887-88
(statement of Charles E. Mitchell, Chairman, National City Bank of New York and National
City Co.) (estimating that NCC sold $20 billion of bonds and stocks prior to 1933); id. at
1926-27 (statement of Hugh B. Baker, President, National City Co.) (same).

\(^{57}\) See Cleveland & Huertas with Strauber et al., supra note 15, at 139, 140
tbl.8.1 (showing that $50.27 billion of domestic and foreign bonds were issued in the United
in the field of foreign bonds. It originated or participated in the
distribution of more than a third of all foreign bonds sold in the United
States between 1921 and 1929. 58

Chase’s securities affiliate, CSC, also established a far-flung
network of sales offices. In 1927, CSC began to make retail sales of
securities to small investors, thereby expanding its operations beyond
wholesale distributions of securities to institutional investors. After
acquiring the Harris Forbes securities firm in 1930, CSC operated
more than fifty sales offices in the United States as well as several
foreign offices. 59 CSC sold $6.16 billion worth of domestic and
foreign securities to investors between its founding in 1917 and its
dissolution in 1933, and most of those securities were sold between
1927 and 1930. 60

National City and Chase were the largest banks in the United
States in 1929 and 1930, respectively. 61 As described below, National
City and Chase provided large amounts of loans, investments, and
other support for the securities activities of NCC and CSC. 62 The
managements of both organizations closely coordinated the operations
of their banks and securities affiliates. 63 Under Mitchell’s leadership,
National City and NCC worked together to create “a global, all-
purpose financial intermediary” that functioned as a financial
department store. 64 As Mitchell explained during a congressional
hearing, National City offered “a complete banking and investment

58. See id. at 140 tbl.8.1, 145-46, 146 tbl.8.4 (showing that $10.27 billion of foreign
bonds were issued in the United States from 1921-1929 and that NCC originated or
participated in $3.78 billion of those bond issues).

59. Peach, supra note 9, at 533-35.

60. Id. at 535 n.65, 593-96; Stock Exchange Practices: Hearings on S. Res. 84 and S.
Res. 56 Before the S. Comm. on Banking & Currency, 73d Cong. 2281-82 (1933)
[hereinafter Senate Chase Hearings] (statement of Albert H. Wigin).

61. CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 157 (stating that
National City was the largest U.S. bank in June 1929); Peach, supra note 9, at 455 n.4 (stating
that Chase surpassed National City to become the largest U.S. bank when Chase acquired
the Equitable Trust Co. in 1930).

62. See infra Part III.B.

63. See CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 127-30,
139-43; Peach, supra note 9, at 525-29, 532-35.

64. CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 156; see also
CHARLES R. GEISST, WALL STREET: A HISTORY 153, 170 (updated ed. 2012) (discussing the
strategy of National City and other large U.S. banks to create “financial department stores”);
Peach, supra note 9, at 451, 510 (describing the desire of universal banks to offer “department
store banking” that included commercial and investment banking services).
and trust service” to its clients so that they could obtain all of their financial services “under one roof.”

National City, Chase, and other universal banks played key roles in promoting the sale of tremendous volumes of debt and equity securities during the 1920s. Contemporary observers concluded, and modern scholars agree, that the securities boom of the 1920s could not have reached the same magnitude without the involvement of large universal banks. Universal banks used their deposits to provide funding for margin loans that enabled investors to buy securities, as well as business loans that cemented their relationships with corporate issuers. Universal banks also used their branches and affiliate offices to market securities to large customer bases, which included depositors, trust customers, middle-class professionals, and small correspondent banks. In addition, universal banks gained the trust of


66. See Wilmarth, supra note 9, at 577 (explaining that, from 1919 to 1929, $49 billion of securities were issued by U.S. corporations, $14 billion of debt securities were issued by state and local governments, and $11 billion of securities were issued in the United States by foreign governments and corporations).

67. Senator Frederick Walcott declared in 1932 that the “flood tide of speculation” during the 1920s would never have occurred without the credit and distribution facilities provided by universal banks. Traditional investment banking firms like J.P. Morgan & Co. and Kuhn, Loeb & Co. did not possess the financial resources or infrastructure needed to accomplish the massive public offerings of domestic and foreign securities that occurred during the 1920s. Those offerings required nationwide distribution networks and “very expansive credit, which, of course, brought in the banks.” 75 CONG. REC. 9904 (1932) (statement of Sen. Walcott). With regard to bank securities affiliates, Walcott observed, “[T]heir growth has been phenomenal, coincident with the growth of the security business . . . .” Id. at 9904-05; see also id. at 9888 (statement of Sen. Glass) (contending that securities affiliates of banks “were perhaps the greatest contributors to the riot of credit and inflation in 1928-29, with the result that the country is now almost in an irreparable condition”); CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 139-47 (explaining that National City’s credit resources and distribution facilities provided “placing power” that established NCC’s status as a top underwriter of securities and also noting that J.P. Morgan & Co. and Kuhn, Loeb & Co. had “no retail distribution of their own, while National City had the country’s best”); GESST, supra note 64, at 159-62, 172 (discussing the important role played by universal banks in promoting public offerings of securities during the 1920s); Peach, supra note 9, at 512-13, 541-50 (describing the growth of bank securities operations during the 1920s and the competitive advantages enjoyed by universal banks in underwriting and distributing securities).

68. CAROSSO, supra note 9, at 273-77; CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 127-31, 139-43, 156-58; Peach, supra note 9, at 451-52, 466-69, 549-50.

69. See CAROSSO, supra note 9, at 275-76; CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 135-43, 152-53; Peach, supra note 9, at 466-69.
unsophisticated investors based on the banks’ public reputations for soundness, stability, and investment expertise.\(^{70}\)

3. After Producing Significant Profits During the 1920s, the Securities Activities of National City and Chase Inflicted Huge Losses on Both Banks During the Early 1930s

National City and Chase reaped large profits from their securities activities during the 1920s, but they suffered crippling losses after the stock market crashed in October 1929. NCC generated total profits of $25 million during the boom years from 1925 to 1929.\(^{71}\) In contrast, NCC suffered more than $100 million of losses from the end of 1929 through the end of 1932, and those losses erased more than 80% of NCC’s capital.\(^{72}\) After earning total profits of more than $85 million between 1925 and 1929, National City’s banking operations recorded almost $170 million of losses from January 1930 through January 1934, which wiped out two-thirds of National City’s shareholders’ equity.\(^{73}\) Many of National City’s losses resulted from bad loans that the bank made to support NCC’s securities activities.\(^{74}\)

Chase’s record was almost as bad as National City’s. After reporting profits of about $20 million between 1925 and 1929, CSC wrote down its capital account by $55 million between 1930 and 1933.\(^{75}\) Chase reported total losses of $130 million from its banking operations between 1930 and 1934, cutting its net worth by more than half.\(^{76}\) Many of those losses were caused by bad loans that Chase made to prop up CSC’s securities deals.\(^{77}\)

\(^{70}\) See CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 135-39; PERINO, supra note 9, at 132-36, 254-56; Peach, supra note 9, at 475, 490, 580.

\(^{71}\) CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 390 n.44.

\(^{72}\) See id. at 160, 161 tbl.9.2 (showing that NCC’s capital declined from $129 million to $21 million between the end of 1929 and the end of 1932).

\(^{73}\) See id. at 191; see also id. at 134 tbl.7.8 (showing that National City earned total profits of $86.5 million between 1925 and 1929).

\(^{74}\) Wilmarth, supra note 9, at 602; see also infra notes 202-204 and accompanying text (discussing NCC’s borrowing from National City to facilitate NCC’s stock purchases).

\(^{75}\) See Senate Chase Hearings, supra note 60, at 2388-89 committee exhibit 8 (showing CSC’s profits from 1925 to 1929 and documenting that CSC created $119 million of reserves against losses between 1929 and 1933); Wilmarth, supra note 9, at 602.

\(^{76}\) Wilmarth, supra note 9, at 602; see also Senate Chase Hearings, supra note 60, at 2355 committee exhibit 6 (showing that Chase created $212 million of reserves against losses between 1929 and 1933).

\(^{77}\) Wilmarth, supra note 9, at 602-03; see also infra notes 205-207 and accompanying text (discussing loans Chase made to support CSC’s sale of Cuban bonds and to restructure and refinance General Theatres Equipment, Inc., and Fox Film Corporation).
National City and Chase announced plans to shut down their securities affiliates in March 1933, even before Congress passed Glass-Steagall. In December 1933, National City and Chase each sold $50 million of preferred stock to the RFC, which Congress established for the purposes of providing assistance to troubled banks and other struggling enterprises. The RFC’s capital stock infusions helped National City, Chase, and their affiliates absorb losses from depreciated investments and nonperforming loans. National City and Chase followed highly conservative business policies to recover from their devastating losses during the Great Depression. Like many other banks, National City and Chase cut their dividends, reduced their loan portfolios, increased their cash reserves, and shifted their assets to safer, highly liquid investments such as government securities.

III. THE PECORA HEARINGS REVEALED WIDESPREAD ABUSES AND CONFLICTS OF INTEREST IN THE SECURITIES ACTIVITIES OF NATIONAL CITY AND CHASE

A. The Collapse of the Securities Markets During the Great Depression and Revelations of Securities Abuses During the Pecora Hearings Destroyed the Public’s Faith in Wall Street

The collapse of securities values during the Great Depression inflicted devastating losses on investors. Stocks listed on the New York Stock Exchange (NYSE) declined in value by more than 80% between September 1929 and July 1932, wiping out over $74 billion of shareholder investments. Domestic and foreign bonds listed on the NYSE declined in value by more than 35% between September 1930 and April 1933, destroying almost $19 billion of bondholder investments.
investments. As a United States Senate committee report observed in 1934, “The annals of finance present no counterpart to this enormous decline in security prices.” In the committee’s view, this implosion of securities values contributed significantly to

[the wholesale closing of banks and other financial institutions; the loss of deposits and savings; the drastic curtailment of credit; the inability of debtors to meet their obligations; . . . the diminution of the purchasing power of the people to the point where industry and commerce were prostrated; and the increase in bankruptcy, poverty, and distress . . . .]

Plummeting securities values and the accompanying Great Depression destroyed the public’s faith in Wall Street. As Vincent Carosso observed, “Rarely had a group lost so much status and respect so rapidly as had investment bankers in the three years following the great stock market crash.” In 1932 and 1933, the “tarnished public image” of investment bankers “deteriorate[d] still further” as congressional investigators produced evidence of a wide range of securities abuses and conflicts of interest.

As the lead investigator and chief counsel for a series of Senate committee hearings, Ferdinand Pecora uncovered serious misconduct by both independent securities firms and securities affiliates of commercial banks. Pecora’s role was so pivotal that the Senate hearings became known as the “Pecora hearings.” Prior to Pecora’s appointment as chief counsel in early 1933, the “public’s simmering and unfocused anger at Wall Street” had not yet produced strong momentum for comprehensive financial reform. The shocking

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81. See id. (reporting that the value of all listed bonds fell from $49.29 billion to $30.6 billion during that period).
82. Id.
83. Id.
84. CAROSSO, supra note 9, at 320; see also id. at 305 (“The events of the crash made a mockery of the investment bankers’ much touted expertise and overoptimistic forecasts.”). As Bernard Baruch similarly explained, “The stereotype of bankers as conservative, careful, prudent individuals was shattered in 1929.” RON CHERNOW, THE HOUSE OF MORGAN: AN AMERICAN BANKING DYNASTY AND THE RISE OF MODERN FINANCE 320 (1990) (quoting Baruch).
85. CAROSSO, supra note 9, at 320-21.
86. PERINO, supra note 9, at 5 (“Pecora’s stellar performance was so dominating, his questioning so riveting, and his investigations so thorough that the [Senate] Banking and Currency [Committee] hearings eventually became known simply as the Pecora hearings.”); see also CAROSSO, supra note 9, at 352-53 (referring to the “Pecora investigation” and the “Pecora hearings”). For Pecora’s account of the investigation he led, see FERDINAND PECORA, WALL STREET UNDER OATH: THE STORY OF OUR MODERN MONEY CHANGERS (1939).
87. PERINO, supra note 9, at 88.
revelations of Pecora’s investigations proved to be a decisive factor in mobilizing popular support for both Glass-Steagall and the Securities Act of 1933.88

B. Pecora’s Findings of Serious Abuses at National City and Chase Discredited the Universal Banking Concept

Pecora’s investigations of National City and Chase—the two largest U.S. banks, which also controlled the two largest securities affiliates—had great significance for the future of the banking and securities industries. Pecora exposed a wide range of unsound financial practices, deceptive conduct, conflicts of interest, and insider self-dealing at National City and Chase. His findings discredited the leaders of both banks and turned public opinion against the financial-department-store concept of universal banking.89

As shown below, National City and Chase encouraged unsophisticated investors to purchase risky securities through high-pressure sales techniques and misleading prospectuses. Both banks used stock pools and other manipulative techniques to promote the sale and boost the price of their own stocks as well as stocks of favored clients. Both banks incurred large losses after making hazardous loans and investments to support the activities of their securities affiliates. Senior executives at both banks reaped extraordinary personal gains by exploiting their managerial positions.

1. National City and Chase Sold Risky Securities Based on Offering Materials that Misled Investors

National City and Chase sold huge volumes of securities to their depositors, small correspondent banks, and other unsophisticated investors.90 As discussed above, National City and Chase built far-flung branch networks to facilitate public distributions of securities that were issued by a wide range of domestic and foreign governments and business firms.91 The mass advertising and direct marketing programs used by National City and Chase encouraged investors to

88. Carasso, supra note 9, at 348-53, 368-71; Perino, supra note 9, at 4-7, 208-11, 221-26, 280-90; Seligman, supra note 9, at 2, 29-30, 37-38, 72.
89. Carasso, supra note 9, at 328-35, 346-56, 370-72; Perino, supra note 9, at 208-11, 221-26, 280-83, 292; Peach, supra note 9, at 551-80.
90. Cleveland & Huertas with Strauber et al., supra note 15, at 135-53; Peach, supra note 9, at 525-35, 542-46; Wilmarth, supra note 9, at 565-66, 573-76, 592-93.
91. See supra notes 53-60 and accompanying text (describing the magnitude of National City’s and Chase’s activities in underwriting and selling securities).
place their trust and confidence in the ability of both banks and their securities affiliates to select suitable investments for their customers.\textsuperscript{92}

As described below, that confidence proved to be tragically misplaced because many of the securities distributed by National City and Chase defaulted or plummeted in value during the early 1930s.

NCC’s marketing campaigns “assured prospective customers that if they saved, [NCC] would advise them how to invest.”\textsuperscript{93} One NCC advertisement warned investors that they “should not try to decide alone” and should instead rely on “the considered opinion of a worldwide investment organization . . . . National City judgment as to which bonds are best for you is based on both strict investigation of the security and analysis of your own requirements.”\textsuperscript{94} Another advertisement assured investors, “When you buy a bond recommended by [NCC], you may be sure that all the essential facts which justify [NCC’s] own confidence in that investment are readily available to you.”\textsuperscript{95}

In his March 1919 lecture to National City’s and NCC’s trainees, Mitchell explained that small investors could not be expected to make informed decisions about bond investments. He therefore declared that NCC owed a duty of trust and suitability in recommending securities to such investors:

"We have gained the confidence of the investor and we are building our institution upon that confidence. We want the public to feel safe with us. We are going to make more exacting our yard-stick, because the small investor who buys from us today a thousand or a five hundred dollar bond is not in a position to know whether that security is good or not and must rely on us. . . . [W]e recognize that as between ourselves and this small investor, the law of caveat emptor cannot apply, and that if we are to fulfill our trust, we must supply that which means safety and a reasonable return to him."\textsuperscript{96}

Unfortunately, as shown below, National City and NCC used marketing and sales techniques that were far removed from the concepts of trust and suitability articulated by Mitchell. NCC’s headquarters office sent to its regional offices a steady stream of “flashes,” which contained sales recommendations and offers of cash

\textsuperscript{92} Cleveland & Huertas with Strauber et al., supra note 15, at 135-39, 154, 157-58; Peach, supra note 9, at 457-58, 466-67, 525-35.

\textsuperscript{93} Cleveland & Huertas with Strauber et al., supra note 15, at 137.

\textsuperscript{94} Id. at 138 fig.8.1 (reproducing an NCC advertisement).

\textsuperscript{95} Perino, supra note 9, at 236 (quoting an NCC advertisement) (emphasis added).

\textsuperscript{96} Cleveland & Huertas with Strauber et al., supra note 15, at 139 (quoting Mitchell, supra note 48).
prizes and other incentives for good performance by sales representatives. National City and NCC also supplied hundreds of thousands of names of prospective customers (including National City depositors) to NCC’s sales force. Mitchell demanded a high level of production from NCC’s sales force. He warned that NCC would not retain “any man in our sales crowd who would confess to his inability to sell at least some of any issue of either bonds or preferred stock that we think good enough to offer.”

Many of the securities sold by National City and Chase proved to be disastrous investments for their customers. Two studies determined that securities underwritten by National City and Chase had higher default rates than securities underwritten by other banks. The first study, by James Ang and Terry Richardson, examined default histories for issues of domestic and foreign corporate bonds and foreign government bonds that were advertised in the Wall Street Journal from 1926 to 1930. Ang and Richardson determined that the default rates for bonds underwritten by National City and Chase were higher compared with other commercial banks with securities affiliates; were much higher compared with the two leading private banks, J.P. Morgan & Co. and Kuhn, Loeb & Co.; and were about the same as investment banks (securities firms).

The second study, by Manju Puri, studied default records for domestic industrial bonds, preferred stock, and foreign government bonds that were issued in the United States from 1927 to 1929. Puri determined that seven-year cumulative default rates for securities underwritten by National City and Chase were higher compared with nonbank underwriters as well as other commercial banks that

97. PECORA, supra note 86, at 88-92; PERINO, supra note 9, at 198-200; SELIGMAN, supra note 9, at 24.
98. NCC’s “new business department” provided the names of more than 220,000 prospective customers to NCC’s sales force between 1927 and 1929, with many of those names drawn from tax lists and automobile registration lists. In addition, National City’s employees referred depositors who were interested in investments to NCC’s sales agents. See Senate National City Hearings, supra note 20, at 2015-20 (statement of Hugh B. Baker); S. REP. NO. 73-1455, at 167 (1934).
99. SELIGMAN, supra note 9, at 24-25 (quoting a telegraph that Mitchell sent).
100. See PERINO, supra note 9, at 135-36 (explaining that the Senate Committee on Banking and Currency “received hundreds of letters from former customers and investors [of National City], all with tales of ruin from following the bank’s advice,” and that many of the letter writers were “utterly devastated by investing with [National City] and . . . were barely hanging on as the economy tumbled into the abyss”).
controlled securities affiliates.\textsuperscript{102} Defaults occurred on more than half of the securities issues that were underwritten by National City and Chase and included in the data sets constructed by Ang, Richardson, and Puri.\textsuperscript{103}

As shown in the following summaries of transactions examined during the Pecora hearings, National City and Chase used materially misleading prospectuses to promote their sales of hazardous securities. In many cases, National City and Chase officials knew or should have known that their offering materials did not fairly disclose the very high investment risks inherent in those securities.

a. NCC’s Sale of Peruvian bonds

NCC was part of the underwriting group for three issues of Peruvian bonds, totaling $90 million, which were sold to the public between March 1927 and October 1928.\textsuperscript{104} Before selling those bonds,
National City and NCC received a series of highly negative reports on economic and political conditions in Peru. A December 1921 report warned that Peru’s finances were “positively distressing” and that “the government treasury is flat on its back and gasping for breath.” A July 1923 report advised, “Peru has been careless in the fulfillment of [its] contractual obligations.” A December 1925 report cautioned, “[T]he internal debt of Peru has not yet been placed on a satisfactory footing.” At about the same time, a vice president of NCC wrote an internal memorandum describing Peru’s “bad-debt record” as well as its “adverse moral and political risk” and “bad internal debt situation.”

In a July 1927 report sent to Mitchell, J.H. Durrell referred to Peru’s “uncertain” political situation as well as “factors that will long retard the economic importance of Peru.” Durrell also stated that he had “no great faith in any material betterment of Peru’s economic condition in the near future.” A March 1928 report advised that Peru’s “whole taxation system is a hodge-podge.” An October 1928 report warned that “[e]conomic conditions in the country leave considerable to be desired” and that “local banks are still badly over extended,” while the Peruvian government’s “budget is not balanced and in fact the floating debt is larger than ever.”

105. Senate National City Hearings, supra note 20, at 2053 (statement of Hugh B. Baker) (quoting Letter from C.W. Calvin, Representative, Nat’l City Bank of N.Y., to J.T. Cosby, Vice President, Nat’l City Bank of N.Y. (Dec. 9, 1921)).
106. Id. at 2058 (quoting Memorandum from C.M. Bishop, Emp., Foreign Dep’t, Nat’l City Bank of N.Y., to A.W. Dunham, Manager, Foreign Dep’t, Nat’l City Bank of N.Y. (July 12, 1923)).
107. Id. at 2061 (quoting a report dated December 16, 1925, authored by “E.A.K.”). Although National City received a somewhat more favorable report from C.W. Calvin in November 1925, National City decided not to participate in a loan to Peru in March 1926. Id. at 2061-67.
108. Id. at 2065-66 (quoting an undated, handwritten memorandum prepared by Victor Schoepperle). Victor Schoepperle was “a vice president of [NCC and] had devoted most of his time since 1919 to the company’s foreign financing.” S. Rep. No. 73-1455, at 127.
112. Senate National City Hearings, supra note 20, at 2113-14 (statement of Victor Schoepperle, Vice President, National City Co.) (quoting Memorandum from H.E.
Notwithstanding the foregoing reports, the offering prospectuses distributed by National City and the other underwriters did not contain any references to Peru’s past defaults on its debts, its current economic problems, or the very weak condition of its government finances.\textsuperscript{113} Peru defaulted on all three issues of bonds in 1931, and by 1933, the market values of those bonds had fallen by more than 90% since the dates of their issuance.\textsuperscript{114}

b. NCC’s Sale of Minas Gereas Bonds

In March 1928 and September 1929, NCC underwrote two issues of bonds, totaling $16.5 million, which were issued by the Brazilian state of Minas Gereas.\textsuperscript{115} NCC sold those bonds to the public after receiving highly adverse reports about the state’s creditworthiness. A June 1927 report advised that “the laxness of the State authorities borders on the fantastic” and also warned about “the complete ignorance, carelessness and negligence of the former State officials in respect to external long-term borrowing.”\textsuperscript{116} In April 1928, after the first bond issue had been sold, NCC received another report, cautioning, “[T]here is a considerable degree of uneasiness on the part of all concerned over the question of the State’s willingness to meet its obligations.”\textsuperscript{117}

In spite of those reports, NCC’s prospectuses for both issues of bonds stated, “Prudent and careful management of the State’s finances has been characteristic of successive administrations in Minas Gereas.”\textsuperscript{118} That statement appeared in both prospectuses, even though an NCC official warned that it would expose NCC to “criticism” in view of “the extremely loose way in which the external debt of the State was managed.”\textsuperscript{119}

\textsuperscript{113} S. REP. NO. 73-1455, at 128-29, 131.
\textsuperscript{114} Id. at 126, 128-31; see also PERINO, supra note 9, at 234-37 (describing Pecora’s investigation of the Peruvian bond offerings).
\textsuperscript{115} Senate National City Hearings, supra note 20, at 2132-33 (statement of Ronald M. Byrnes, Former Vice President, National City Co.).
\textsuperscript{116} Id. at 2155 (statement of George F. Train, Member, Foreign Department, National City Co.) (quoting Letter from George F. Train, Member, Foreign Dep’t, Nat’l City Co., to R.M. Byrnes, Vice President, Nat’l City Co. (June 12, 1927)).
\textsuperscript{117} Id. at 2152 (quoting Letter from George F. Train, Member, Foreign Dep’t, Nat’l City Co., to M.E. Squires, Acting Manager, Nat’l City Bank of N.Y. (Apr. 27, 1928)).
\textsuperscript{118} Id. at 2156.
\textsuperscript{119} Id. at 2157 (quoting Letter from Samuel W. Baldwin, Treasurer, Nat’l City Co., to George F. Train, Member, Foreign Dep’t, Nat’l City Co. (Sept. 14, 1927)). George Train testified that the statements in both prospectuses as to the “[p]rudent and careful management
The prospectus for the second bond issue was also misleading because it did not disclose that almost half of the $8 million worth of proceeds would be used to pay off short-term loans that the underwriters had extended to Minas Gereas. NCC’s underwriting group made those loans to Minas Gereas after the first bond issue failed to satisfy the state’s funding needs. As Pecora’s questioning also revealed, NCC’s underwriting group provided the loans in order to retain Minas Gereas’s loyalty at a time when Kuhn, Loeb & Co. and other underwriters were trying to attract the state’s future bond business.

The prospectus for the second bond issue stated that “[t]he proceeds of this loan will be utilized for purposes designed to increase the economic productivity of the State” and would comply with “law No. 1061 of August 16, 1929.” The prospectus did not disclose that nearly half of the bond proceeds would be used to repay the short-term loans made by NCC’s underwriting group. Nor did it disclose that NCC’s Brazilian counsel had “drafted the law” (Law No. 1061) that allowed NCC’s underwriting group to recoup their loans from the bond proceeds. Minas Gereas defaulted on both bond issues in March 1932. By 1933, the market values of the bonds had fallen by more than three-quarters.
c. National City’s Sale of Stock To Finance a Disguised Bailout of Its Nonperforming Cuban Loans

Along with Chase and other large New York banks, National City made a disastrous foray into the Cuban sugar industry during World War I. The market price for Cuban sugar skyrocketed during the war and its immediate aftermath, due in large part to the disruption of beet sugar production in Europe. National City opened branches across Cuba and made extensive loans and investments in Cuba that equaled 80% of its capital in 1921.\(^\text{126}\)

The revival of European beet sugar production after the war led to a collapse of the price for Cuban sugar. Many Cuban sugar producers defaulted on their bank loans, and National City’s Cuban branches were left with more than $60 million worth of nonperforming loans in 1921.\(^\text{127}\) Mitchell organized General Sugar Corporation (General Sugar) in 1922 to take control of National City’s foreclosed Cuban properties in order to bring those properties back into operation.\(^\text{128}\)

The Cuban sugar industry failed to recover after 1922, and National City still held more than $30 million worth of nonperforming Cuban loans on its books in 1927. National bank examiners repeatedly criticized those loans.\(^\text{129}\) To solve this urgent problem, National City sold $50 million worth of newly issued stock to its shareholders in 1927. Half of those funds were contributed to National City’s capital, and the other half were added to NCC’s capital.\(^\text{130}\) NCC immediately invested its $25 million of new funds in General Sugar, and General Sugar then paid $21 million in cash and $11 million in

\(^{126}\) CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 105-06; see also J.T.W. HUBBARD, FOR EACH, THE STRENGTH OF ALL: A HISTORY OF BANKING IN THE STATE OF NEW YORK 181-85 (1995) (discussing the roles of National City and other banks in financing Cuba’s development); Senate National City Hearings, supra note 20, at 1792-93 (statement of Charles E. Mitchell) (stating that National City made “very large loans” to support the Cuban sugar business).

\(^{127}\) Senate National City Hearings, supra note 20, at 1792-93 (statement of Charles E. Mitchell); CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 105-06; HUBBARD, supra note 126, at 185.

\(^{128}\) Senate National City Hearings, supra note 20, at 1789-93 (statement of Charles E. Mitchell); CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 108-09; see also HUBBARD, supra note 126, at 185 (describing National City’s ownership of extensive foreclosed properties in Cuba, including railroads, sugar mills, and sugar plantations).

\(^{129}\) Senate National City Hearings, supra note 20, at 1793-95, 1798-99, 1835 (statement of Charles E. Mitchell); CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 109.

\(^{130}\) Senate National City Hearings, supra note 20, at 1788-89 (statement of Charles E. Mitchell).
notes to National City to acquire the bank’s portfolio of delinquent Cuban loans.\textsuperscript{131}

Thus, the General Sugar transaction “neatly excised the Cuban debt from [National City’s] books and placed it in [NCC], with the bank’s shareholders picking up the tab.”\textsuperscript{132} The shareholders who bought the $50 million of newly issued National City stock in 1927 were not told that half of their investment would be used to finance General Sugar’s acquisition of National City’s delinquent Cuban loans.\textsuperscript{133} When pressed on that point by Pecora, Mitchell replied, “I hardly think there was any necessity [for such disclosure].”\textsuperscript{134} However, as Michael Perino has pointed out: “Mitchell was clearly using [NCC] to obscure [National City’s] mistakes, both to outsiders and to the bank’s own shareholders. As Mitchell confided to one of his bond salesmen, ‘We wash our dirty linen on the back porch rather than on the front porch.’”\textsuperscript{135}

d. NCC’s Sale of Lautaro Nitrate Co. Bonds

In August 1929, NCC led an underwriting group that sold $32 million of convertible bonds issued by Lautaro Nitrate Co. (LNC), the largest producer of sodium nitrate fertilizer in Chile.\textsuperscript{136} Before the bonds were issued, NCC sent Sterling Bunnell, an engineer, to study the Chilean sodium nitrate industry. Bunnell informed NCC that the Chilean nitrate industry was threatened by increasing competition from synthetic nitrate produced in Europe and the United States. In addition, the sale of Chilean nitrate to foreign markets was hindered by a high export duty imposed by the Chilean government.\textsuperscript{137} Bunnell advised NCC that the “unknown factor is obsolescence” with respect to the future profitability of Chilean nitrate, and “it is impossible to prophesy the conditions which may exist in the Chilean nitrate industry within the 25-year term of [the] new [bond] financing.”\textsuperscript{138} Bunnell concluded that highly uncertain conditions in Chilean and

\textsuperscript{131.} \textit{Id.} at 1789-97. General Sugar eventually paid about $2 million of the notes it issued to National City. \textit{Id.} at 1795. NCC subsequently wrote down its entire investment in General Sugar to $1. \textit{Id.}

\textsuperscript{132.} \textit{PERINO, supra} note 9, at 160.

\textsuperscript{133.} \textit{Senate National City Hearings, supra} note 20, at 1796-97, 1833-34 (statement of Charles E. Mitchell).

\textsuperscript{134.} \textit{Id.} at 1833.

\textsuperscript{135.} \textit{PERINO, supra} note 9, at 161.

\textsuperscript{136.} \textit{Senate National City Hearings, supra} note 20, at 2298-99, 2310-11 (statement of Ronald M. Byrnes).

\textsuperscript{137.} \textit{Id.} at 2317-19.

\textsuperscript{138.} \textit{Id.} at 2320-21 (quoting a report written by Bunnell, dated August 10, 1929).
world markets for nitrate made the proposed bond offering “speculative” from “the banking viewpoint.”

NCC’s prospectus for LNC’s bonds did not refer to Bunnell’s study or his analysis of the competitive threat posed by synthetic nitrate. The prospectus also did not disclose a significant conflict of interest on NCC’s part. A few months earlier, NCC had underwritten a $30 million bond offering by American I.G. Chemical Co. (AIGC). AIGC owned I.G. Farbenindustrie, a major producer of European synthetic nitrate that competed directly with LNC’s Chilean nitrate. LNC’s bonds defaulted, and the market value of those bonds fell by more than 95% by 1933.

e. CSC’s Sale of Cuban Bonds

Like National City, Chase suffered large losses after making an ill-considered foray into Cuba. Chase and CSC arranged a complex series of financings for Cuba between 1927 and 1930. In February 1927, Chase and Blair & Co. (Blair) extended $10 million worth of loans to support a new Cuban public works program. In June 1928, Chase, Blair, and two other banks provided $30 million of additional loans to Cuba, and a CSC-led underwriting group sold $20 million of Cuban bonds to the public.

In February 1930, CSC’s underwriting group agreed to make a second public offering of $40 million of Cuban bonds, and the Chase-led banking group promised to provide $20 million of additional loans to Cuba. In return, Cuba agreed that the proceeds of the second bond offering could be used to pay off the $40 million of loans that Chase’s banking group had previously extended to Cuba. Thus, as a practical matter, the banks and underwriters used the 1930 bond offering to shift $40 million worth of sovereign credit risk from the banks to public investors.

139. Id. at 2320 (quoting a report written by Bunnell, dated August 10, 1929).
140. Id. at 2319-21.
141. Id. at 2321-23.
142. See id. at 2299, 2309.
143. S. REP. No. 73-1455, at 134 (1934).
144. Id. at 134-35. The banking group sold $20 million of bonds (“serial certificates”) to investors in two equal installments in October 1928 and January 1929. Id.
145. Id. at 138; Senate Chase Hearings, supra note 60, at 2711-12, 2714-16 (statement of Shepard Morgan, Vice President, Chase National Bank of the City of New York); id. at 2747-48 (statement of A.M. Williams, Counsel, Rushmore, Bisbee & Stern).
146. Peach, supra note 9, at 574-75.
In order to attract and retain Cuba’s business, CSC’s underwriting group paid large amounts of fees to friends and business associates of Cuba’s president, Gerardo Machado. In addition, Chase made substantial loans to President Machado and his business firms, as well as his friends, associates, and other key Cuban officials.\(^\text{147}\) Chase’s Havana branch employed José Obrégón, the son-in-law of President Machado, even though Chase officials believed that “from any business standpoint,” Obrégón was “perfectly useless.”\(^\text{148}\) The prospectuses for the 1928 and 1930 Cuban bond offerings did not disclose to investors the special accommodations that Chase and CSC had provided to influential Cubans.\(^\text{149}\)

The prospectuses for the Cuban bonds indicated that Cuba’s government had generated significant budget surpluses for several years when, in fact, the government ran a net deficit.\(^\text{150}\) The prospectuses also misled investors by stating that Cuba would create a “special account” into which designated revenues would be deposited each year to ensure repayment of the bonds.\(^\text{151}\) Cuba established an “accounting fund” for the designated revenues, but Chase learned in 1929 that Cuba was comingling the designated revenues with general funds and planned to use designated revenues to meet its general operating expenses.\(^\text{152}\)

The prospectus for the 1930 bond offering did not disclose that Cuba’s government had run a budget deficit of more than $7.4 million

\(^{147}\) Senate Chase Hearings, supra note 60, at 2630-48 (statement of Adam K. Geiger, Second Vice President, Chase National Bank of the City of New York); S. REP. NO. 73-1455, at 215; PECORA, supra note 86, at 164-65.

\(^{148}\) Senate Chase Hearings, supra note 60, at 2630-31 (statement of Adam K. Geiger) (quoting Letter from James Bruce, Vice President, Chase Nat’l Bank of the City of N.Y., to Joseph Rovensky, Vice President, Chase Nat’l Bank of the City of N.Y. (Feb. 23, 1931)); accord PECORA, supra note 86, at 165-66.

\(^{149}\) See Senate Chase Hearings, supra note 60, at 2812-13 committee exhibit 54 (reprinting the prospectus for the $40 million of bonds offered to the public in February 1930).

\(^{150}\) The 1928 and 1930 prospectuses each stated that during the previous five-year period, the “ordinary revenues” of Cuba’s government exceeded its “ordinary expenditures” by more than $22 million. In contrast, the underwriters’ application to list Cuban bonds on the NYSE in 1930 disclosed that the expenditures of Cuba’s government for the four fiscal years preceding June 30, 1928, exceeded the government’s revenues by about $4 million. S. REP. NO. 73-1455, at 135. Cuba’s Secretary of the Treasury provided the misleading figures that appeared in Chase’s prospectuses, and Chase “did not go back of those figures.” Senate Chase Hearings, supra note 60, at 2668 (statement of Shepard Morgan).

\(^{151}\) S. REP. NO. 73-1455, at 135-36. The designated revenues included gasoline taxes and sales of automobile license plates, which Cuba’s new public works program was expected to stimulate by building a central highway across Cuba. Senate Chase Hearings, supra note 60, at 2548-49 (statement of Shepard Morgan).

\(^{152}\) S. REP. NO. 73-1455, at 136-38.
during its most recent fiscal year. The prospectus also did not include the $40 million of outstanding bank loans when it stated that Cuba’s “total funded debt” was $87 million. As a result, the prospectus created the misleading impression that the 1930 bond offering would reduce Cuba’s “total funded debt” by $40 million. In fact, however, Cuba’s debt remained the same: the $40 million of new bonded debt replaced the bank debt, which was repaid from the bond proceeds.

After receiving additional short-term advances from Chase’s banking group, Cuba paid off the 1928 bonds. However, in 1933, Cuba defaulted on the 1930 bonds, and Cuba also failed to pay the $20 million loan that Chase’s banking group extended in March 1931.

f. CSC’s Sale of Detroit & Canada Tunnel Co. Securities

In May 1928, a CSC-led underwriting group sold to the public $17 million of first mortgage bonds and convertible debentures issued by the Detroit & Canada Tunnel Co. (DCTC). DCTC was organized in 1927 to build a two-lane vehicle tunnel between downtown Detroit, Michigan, and Windsor, Canada. The bond prospectus cited reports from three engineering firms, which estimated that revenues from the tunnel would easily cover the required debt service on the bonds during the first five years of the tunnel’s existence.

The bond prospectus did not disclose that one of the engineering firms had a material conflict of interest. That firm received a stock bonus valued at $250,000, which likely would not have been paid if the

153. Id. at 140. A Chase officer asserted that the Cuban government’s $7.4 million deficit during its fiscal year that ended June 30, 1929, was “not necessarily a material figure,” and it was therefore “a matter of choice” for Chase to omit that information from the 1930 bond prospectus. Senate Chase Hearings, supra note 60, at 2717 (statement of Shepard Morgan).


155. Senate Chase Hearings, supra note 60, at 2748-51 (statements of Shepard Morgan and A.M. Williams).

156. Id. at 2762-63, 2798 (statement of Shepard Morgan) (stating that the Chase underwriting group provided three short-term loans and purchased $867,000 of bonds to enable Cuba to pay off the 1928 bonds between 1931 and 1933).

157. Id. at 2772-73 (stating that the $20 million bank loan became “past due” in March 1933); S. REP. NO. 73-1455, at 142-43 (stating that Cuba failed to pay the required interest on the $40 million of 1930 bonds that became due in June 1933); ILSE MINTZ, DETEORIATION IN THE QUALITY OF FOREIGN BONDS ISSUED IN THE UNITED STATES 1920-1930, at 29-30 (1951) (referring to Cuba’s default on its “external obligations” in 1933).

158. Senate Chase Hearings, supra note 60, at 3890-92, 3906, 3915-16 (statement of Leslie W. Snow, Second Vice President, Chase National Bank of the City of New York).

159. Id. at 3940-41 committee exhibit 202 (reprinting a bond prospectus dated May 1, 1928).
firm had issued an unfavorable report on the tunnel’s prospects. The prospectus also stated that the underwriters “recommend[ed] these bonds for investment,” even though the tunnel would face significant competition from two existing ferry companies as well as a new five-lane bridge that was scheduled to open a year before the tunnel was completed.

The revenues from DCTC’s tunnel fell far short of projections, and DCTC incurred a net loss of $1.8 million during 1931. DCTC defaulted on its debentures in November 1931 and on its first mortgage bonds in 1932. By 1933, the bonds had lost more than 90% of their value and the debentures were worthless.

g. CSC’s Sale of Lincoln Building Securities

In May 1928, a CSC-led underwriting group offered to the public $16 million of mortgage bonds and $5.5 million of debentures issued by the Lincoln Forty-Second Street Corporation (LFSC). LFSC was organized in 1928 to construct a new fifty-three-story office building on 42nd Street in New York City. The prospectuses for both public offerings declared that the new Lincoln Building would be “one of the tallest and most imposing structures in the city” and “one of the finest office buildings in the country.” The prospectuses also assured investors that “demand for high grade office building space and for shops and stores in this very accessible location has been definitely established.” The prospectuses projected that future rental revenues would easily cover the annual debt service on both the bonds and debentures.

160. See id. at 3958-59, 3961-63 (statement of Judson Bradway, Former President, Detroit & Canada Tunnel Co.).
161. Id. at 3940-41 committee exhibit 202 (reprinting a bond prospectus dated May 1, 1928); id. at 3911-12 (statement of Leslie W. Snow). A month before DCTC’s public offering occurred, representatives of the bridge company met with representatives of DCTC and argued that their five-lane bridge would be “superior” to DCTC’s proposed two-lane tunnel. Id. at 3913-14.
162. Id. at 3933-34 (statement of Harry M. Addinsell, Former Officer, Harris, Forbes & Co.).
163. Id. at 3927 (statement of Leslie W. Snow).
164. See id. at 3917.
165. Id. at 4050-52, 4058-64.
166. Id. at 4072-74 committee exhibit 217, 4077-78 committee exhibit 219 (reprinting prospectuses for the first mortgage bonds and for the debentures).
167. Id. at 4072-74 committee exhibit 217.
168. See id. (reprinting the prospectus for the first mortgage bonds); id. at 4077-78 committee exhibit 219 (reprinting the prospectus for the debentures).
The prospectuses did not disclose that two members of Chase’s board of directors had opposed CSC’s involvement in the Lincoln building project or that a Chase officer had questioned the project’s viability.\textsuperscript{169} CSC’s underwriting group had difficulty selling both the bonds and the debentures, and the underwriters were obliged to purchase more than $400,000 of the bonds and almost $3.8 million of the debentures.\textsuperscript{170}

Due to decreased demand for office space in New York City after the stock market crash, the Lincoln Building leased only about half of its offices.\textsuperscript{171} In January 1931, CSC issued an updated prospectus for the first mortgage bonds, which represented that the Lincoln Building had rented 60% of its offices. CSC knew that representation was not true.\textsuperscript{172} The 1931 prospectus also provided a higher valuation for the Lincoln Building than either of the estimated values contained in the 1928 prospectus, even though commercial real estate values had declined in New York City since 1928.\textsuperscript{173}

LFSC defaulted on both its bonds and debentures, and the bondholders began foreclosure proceedings in January 1932. At the foreclosure sale in July 1933, CSC made the highest bid and purchased the Lincoln Building for $4.75 million.\textsuperscript{174} LFSC’s bondholders lost more than 60% of their investments, and LFSC’s debenture holders lost all of their investments.\textsuperscript{175}

\begin{itemize}
\item \textsuperscript{169} Id. at 4062 (statement of Leslie W. Snow); id. at 4099-4100 (statement of George Ramsey, Investment Banker, Chase Harris Forbes Corporation).
\item \textsuperscript{170} Id. at 4061, 4063-64, 4084 (statement of Leslie W. Snow).
\item \textsuperscript{171} Id. at 4058; id. at 4100-03 (statement of George Ramsey).
\item \textsuperscript{172} Id. at 4102-03 (statement of George Ramsey); see id. at 4136-37 committee exhibit 231 (reprinting the updated prospectus dated January 12, 1931).
\item \textsuperscript{173} The 1928 prospectus cited reports from two real estate companies, which assigned estimated values of $25.2 million and $25.9 million to the planned Lincoln Building. The 1931 prospectus cited a 1930 report from one of those companies, which estimated that the completed building was worth $26.7 million. The building’s actual cost was $24.6 million. See id. at 4073 committee exhibit 217 (reprinting the 1928 prospectus); id. at 4103-04 (statement of Leslie W. Snow); id. at 4137 committee exhibit 231 (reprinting the 1931 prospectus).
\item \textsuperscript{174} Id. at 4056-58 (statement of Leslie W. Snow); id. at 4106 (statement of George Ramsey).
\item \textsuperscript{175} Bondholders who deposited their bonds with the bondholders’ protective committee received income debentures after the foreclosure sale. Those income debentures had a market value of less than 40% of par in November 1933. Bondholders who did not deposit their bonds with the protective committee received $337 in cash for each $1,000 of bonds they owned. See id. at 4057, 4084-85 (statement of Leslie W. Snow).
\end{itemize}
2. National City and Chase Manipulated the Prices of Their Own Stocks and Stocks of Favored Clients

National City and Chase organized marketing campaigns and trading pools to pump up the market prices of their own stocks, as well as the stocks of favored corporate clients. Their manipulative techniques artificially inflated market prices for the targeted stocks, encouraged the public to invest in those stocks, and inflicted massive losses on investors when the stock prices later collapsed.

a. National City’s Promotion of Its Own Stock

National City delisted its stock from the NYSE in January 1928 and moved the stock to the over-the-counter market, where NCC could more easily control trading in the stock. NCC then launched a massive campaign to promote the sale of National City’s stock to the public. By the end of 1930, NCC had sold almost two million shares of National City stock, for which investors paid about $650 million. The number of National City’s shareholders rose from less than 16,000 in 1927 to almost 80,000 in 1931.

National City wanted to attract more stockholders in order to create “more business opportunities” and more “prospective customers” for financial services offered by National City and for investments offered by NCC. National City arranged a 5-1 stock split in February 1929 in order to reduce the market price of its stock.

176. Senate National City Hearings, supra note 20, at 1919-24, 1970 (statement of Hugh B. Baker); PERINO, supra note 9, at 181-82. NYSE rules during the 1920s prohibited corporations from becoming members of the NYSE. Consequently, corporations could not trade NYSE-listed stocks except through brokers who were members of the NYSE. Sissoko, supra note 2, at 10-11. By virtue of its status as a corporation, NCC could not directly trade National City’s stock as long as that stock was listed on the NYSE.

177. In carrying out its marketing campaign for National City stock, NCC typically bought shares of National City stock in the open market, either directly or through brokers, and then sold those shares directly to investors. Senate National City Hearings, supra note 20, at 1884 (statement of Gordon S. Rentschler, President, National City Bank of New York); id. at 1890-92, 1919 (statement of Hugh B. Baker). National City provided short-term loans to brokers to finance their purchases of National City stock until the brokers could deliver the stock to NCC. Id. at 1971-80; id. at 1983-85, 1989-97 (statement of Charles E. Mitchell).

178. Id. at 1879-81 (statement of Gordon S. Rentschler) (confirming the amount and value of National City stock that NCC sold to investors between July 1927 and December 1930); see also id. at 1938-1940 (statement of Hugh B. Baker) (describing the rise in the number of National City shareholders).

179. Id. at 1940 (statement of Hugh B. Baker).

180. Id. at 1938; see also PERINO, supra note 9, at 179 (explaining that NCC “intensely marketed [National City] stock to the public, not only to raise the price of the stock, but because broad stock ownership benefited the bank”). “Stockholders became just another group to whom the bank could cross-sell its other financial products.” Id.
so that it would be “within the reach of the smaller investor.”\textsuperscript{181} National City depositors who expressed an interest in buying investments were frequently encouraged to buy National City stock.\textsuperscript{182}

NCC’s selling campaign helped to boost National City’s stock price from $780 per share in January 1928 to $2,900 per share in the fall of 1929 (adjusted for the 5-1 stock split). National City’s stock price fell to $200 per share in early 1933 (similarly adjusted), representing a loss of more than 90% for investors who bought at the market peak.\textsuperscript{183}

National City established a stock-purchase program for its high-ranking officers in February 1927, not long before National City’s stock price began its remarkable ascent. In December 1929, after the stock price had fallen from its peak by about two-thirds, National City established a stock-purchase program for its ordinary employees. Employees bought 60,000 shares of National City stock at prices ranging from $1,000 to $1,100 (adjusted for the 5-1 stock split), and many bought their stock under a four-year plan that deducted installment payments (with interest) from their paychecks.\textsuperscript{184}

As National City’s stock price continued to decline after the stock market crash, National City provided shockingly disparate treatment to its senior officers and ordinary employees. The bank extended $2.4 million of no-interest loans in November 1929 to boost the “morale” of a hundred of its top executives who were struggling to hold onto their National City stock despite margin calls. Those executives repaid only 5% of their “morale” loans, and National City transferred the other 95% to NCC in December 1930, where the loans were either written off or not enforced.\textsuperscript{185}

In sharp contrast, National City rigorously enforced the installment stock-purchase contracts that its ordinary employees signed

\begin{footnotesize}
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\item[181.] Senate National City Hearings, supra note 20, at 1940 (statement of Hugh B. Baker).
\item[182.] Id. at 2019-21.
\item[183.] See id. at 1921-23.
\item[184.] PERINO, supra note 9, at 168-71. For descriptions of the 1927 and 1929 stock-purchase plans, see PECORA, supra note 86, at 128-29. As Perino points out, National City established its employee stock-purchase plan at a time when NCC held a large block of National City stock following the collapse of National City’s proposed merger with the Corn Exchange Bank. See PERINO, supra note 9, at 169-71. Perino suggests that National City’s leadership probably thought that “[p]utting the stock in the hands of the employees rather than selling it back into the market would . . . take additional downward pressure off the [price of National City] stock.” Id. at 171.
\item[185.] Senate National City Hearings, supra note 20, at 1868-72, 1875 (statement of Gordon S. Rentschler). For further discussion of National City’s “morale” loans for senior executives, see PECORA, supra note 86, at 127-28, and PERINO, supra note 9, at 166-68.
\end{enumerate}
\end{footnotesize}
in December 1929, and many of those employees were still paying off their loans in 1933. At that point, the obligations of many employees under their installment contracts were far greater than the value of their National City shares. One newspaper commented that National City’s forgiveness of “morale” loans for its senior executives could not be squared with its harsh treatment of ordinary employees: “[T]he clerks of the bank, who had been urged, and in some cases really driven, to purchasing the bank stock . . . lest they lose the favor of their superior officers, were given . . . no aid whatsoever by the bank in carrying the shares they bought . . . . No moratorium for them! No loans to help them carry on!”

b. Chase’s Trading in Its Own Stock

Chase’s program for boosting its stock price was at least as aggressive as National City’s and produced similarly disastrous results for investors who bought Chase shares at the stock market’s peak in 1929. Like National City, Chase delisted its stock from the NYSE in January 1928, and CSC thereafter purchased and sold Chase stock in the over-the-counter market. Also, like National City, Chase arranged a 5-1 split of its stock in 1929 in order to reduce its market price and make possible a “wider distribution” of Chase stock to small investors.

CSC organized eight trading pools for Chase stock between September 1927 and July 1931. Those trading pools bought and sold $860 million of Chase stock, relying in part on loans provided by Chase. Boosted by this massive trading program, the market price of Chase stock rose from $575 per share in 1927 to $1,325 per share in 1929 (adjusted for the 5-1 stock split), before falling to $89 per share in 1933 (similarly adjusted). Thus, Chase’s large-scale trading in its own stock was comparable to National City’s campaign, and Chase

186. Senate National City Hearings, supra note 20, at 1872-75 (statement of Gordon S. Rentschler). For further discussion of National City’s enforcement of the installment purchase contracts of ordinary employees, see PECORA, supra note 86, at 128-29; PERINO, supra note 9, at 168-69; and S. REP. NO. 73-1455, at 172 (1934).
188. Senate Chase Hearings, supra note 60, at 2373-79 (statement of Albert H. Wiggin). CSC frequently bought and sold Chase stock through its subsidiary, Metpotan Securities Corporation. Id. at 2378-79, 2414.
189. Id. at 2371-73 (describing Chase’s stock split in July 1929).
190. Id. at 2837-39 (statements of Albert H. Wiggin and Henry Hargreaves, Secretary, Chase Corporation); S. REP. NO. 73-1455, at 174-81; PECORA, supra note 86, at 148-50.
shareholders who purchased their stock at the 1929 market peak lost more than 90% of their investments, like their National City peers.\(^{192}\)

c. Trading Pools for Client Stocks

National City and Chase also arranged trading pools to boost the stock prices of favored clients. For example, in late 1928 and early 1929, NCC participated in three pools that traded in the stocks of a subsidiary of Anaconda Copper Mining Co. (Anaconda) and two other copper mining companies that Anaconda intended to acquire. Anaconda’s top two executives, John Ryan and Cornelius Kelley, also participated in those trading pools. The purpose of the pools was to “facilitate” the planned conversion of the stocks of all three companies into Anaconda stock.\(^{193}\)

In August 1929, after the pools had completed their trading and Anaconda had acquired the two mining companies, NCC launched a massive public sales campaign for Anaconda stock. During the next two months, NCC sold over 1.3 million shares of Anaconda stock to the public at a price of about $120 per share. NCC pursued its Anaconda sales campaign despite NCC’s knowledge that the market price of copper had recently fallen from twenty-four cents to eighteen cents per pound. By 1933, Anaconda’s stock price had plunged to $7 per share, more than 90% below the price at which NCC marketed Anaconda’s stock to the public.\(^{194}\)

In October 1928, CSC participated in purchasing and trading syndicates for the stock of Sinclair Consolidated Oil Corporation (Sinclair). Sinclair’s chief executive, Harry Sinclair, and several other officers and directors of Sinclair also participated in the syndicates. The two syndicates bought and sold about 2.5 million shares of Sinclair stock and earned total profits of more than $12.2 million. Chase provided a $12 million short-term loan to assist the purchasing syndicate in buying Sinclair stock.\(^{195}\) The syndicates sold Sinclair stock to the public at a price of about $38 per share. However, by 1933, the stock price had fallen by more than two-thirds, to $12 per share.\(^{196}\)

\(^{192}\) See supra text accompanying notes 183, 191 (describing declines of more than 90% in the stock prices of National City and Chase between 1929 and 1933).

\(^{193}\) S. REP. NO. 73-1455, at 166-67.

\(^{194}\) See id. at 167-68; Senate National City Hearings, supra note 20, at 1854-55, 1862-66 (statement of Charles E. Mitchell).

\(^{195}\) S. REP. NO. 73-1455, at 63-66; see also PECORA, supra note 86, at 169-76 (describing the Sinclair pool operations).

\(^{196}\) Senate Chase Hearings, supra note 60, at 3340-41 (statement of Elisha Walker, Member, Kuhn, Loeb & Co.).
From 1928 to 1932, CSC participated in more than thirty other trading pools beyond those dealing in Chase stock and Sinclair stock.\textsuperscript{197} In Pecora’s view, CSC’s trading pools “were simply raiding expeditions on the market in the spirit of the times” and reflected CSC’s willingness to exploit “the speculative frenzy . . . for its own profit.”\textsuperscript{198}

3. National City and Chase Made Unsound Loans and Investments To Support Their Securities Affiliates

The Pecora hearings showed that National City and Chase closely coordinated the activities of their banks and securities affiliates so that each bank and affiliate operated together as a unified business. Mitchell acknowledged that National City was “inseparably interwoven” with NCC and that the two companies acted together as one “institutional entity.”\textsuperscript{199} Hugh Baker, NCC’s President, admitted that National City helped NCC and that NCC helped National City “all the time.”\textsuperscript{200} Similarly, as Pecora observed with regard to Chase, “[T]he intimate connection, amounting to practical identity, between the Chase Bank proper and its security affiliate did not differ, except in details, from the National City model.”\textsuperscript{201}

National City and Chase frequently made loans to support the securities-underwriting and -trading activities of their securities affiliates. From time to time, NCC borrowed up to the legal limit of $20 million from National City.\textsuperscript{202} National City also made loans to brokers to facilitate NCC’s purchases of National City stock.\textsuperscript{203} In addition, National City extended loans to many of NCC’s customers. In 1930 and 1931, National City carried on its books $80 million of “bridge” loans that the bank had made to customers of NCC in anticipation of securities offerings that NCC could not complete after the stock market crashed.\textsuperscript{204}

In June 1932, Chase held $130 million worth of loans and investments related to CSC’s securities activities, while CSC held $34

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\textsuperscript{197} Id. at 2858-59 committee exhibit 74.
\textsuperscript{198} PECORA, supra note 86, at 184-85.
\textsuperscript{199} Senate National City Hearings, supra note 20, at 1995 (statement of Charles E. Mitchell).
\textsuperscript{200} Id. at 1939 (statement of Hugh B. Baker).
\textsuperscript{201} PECORA, supra note 86, at 138.
\textsuperscript{202} Senate National City Hearings, supra note 20, at 1879 (statement of Gordon S. Rentschler) (acknowledging that NCC sometimes borrowed amounts from National City that were equal to the “entire amount” of the bank’s unsecured lending limit, which was approximately $20 million).
\textsuperscript{203} See supra note 177 and accompanying text.
\textsuperscript{204} CLEVELAND & HUERTAS WITH STRAUBER ET AL., supra note 15, at 171.
\end{flushleft}
million worth of investments in its clients’ securities.\textsuperscript{205} As discussed above, a Chase-led banking group provided $60 million of loans to support the public sale of $60 million of Cuban bonds by CSC’s underwriting group. In 1933, Cuba defaulted on $20 million of those bank loans, and Chase was left holding $9.7 million of delinquent Cuban loans.\textsuperscript{206}

The most disastrous foray by Chase and CSC was their joint effort to reorganize and refinance General Theatres Equipment, Inc. (GTE), and Fox Film Corporation (Fox). A detailed discussion of that debacle is beyond the scope of this Article. It is sufficient to point out that Chase had made $77 million of loans by October 1933 to GTE and Fox and wrote off more than $55 million worth of those loans, while CSC wrote off virtually all of the $14 million CSC invested in GTE and Fox securities.\textsuperscript{207}

4. Senior Executives of National City and Chase Received Extraordinary Compensation and Gains from Self-Dealing

Pecora’s investigation revealed that the top executives of National City and Chase received extraordinary benefits and engaged in abusive insider transactions. National City’s chairman, Mitchell, received salaries and bonuses totaling $3.5 million from 1927 through 1929. The disclosure of Mitchell’s compensation in March 1933, at the Depression’s lowest point, triggered widespread public outrage.\textsuperscript{208}

Mitchell received most of his compensation in the form of bonuses paid by National City and NCC. Under each company’s bonus plan, the first 8% of annual net earnings were retained by the firm (i.e., the shareholders), and 20% of net earnings above the 8% level were paid into a “management fund.” The management fund then distributed bonuses to qualifying senior executives. Mitchell typically received about 40% of the bonuses paid from National City’s management fund and about 30% of the bonuses paid from NCC’s

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\item \textsuperscript{205} Senate Chase Hearings, supra note 60, at 2926 (statement of Albert H. Wiggin).
\item \textsuperscript{206} Id. at 2772-73, 2798-99 (statement of Shepard Morgan); see also supra Part III.B.1.e (describing the financing provided by Chase and CSC for Cuba’s public works program).
\item \textsuperscript{207} Senate Chase Hearings, supra note 60, at 3644-45 committee exhibit 164. For an overview of the GTE/Fox disaster and the losses incurred by Chase and CSC, see BARRIE A. WIGMORE, THE CRASH AND ITS AFTERMATH: A HISTORY OF SECURITIES MARKETS IN THE UNITED STATES, 1929-1933, at 171-75, 220-21, 264, 332, 357 (1985).
\item \textsuperscript{208} S. REP. NO. 73-1455, at 206 (1934); PERINO, supra note 9, at 147, 155-56; Harwell Wells, “No Man Can Be Worth $1,000,000 a Year”: The Fight over Executive Compensation in 1930s America, 44 U. RICH. L. REV. 689, 705-07, 713-15 (2010).
\end{itemize}
management fund. National City and NCC did not seek to recover the bonuses they had paid during the boom when they later suffered massive losses after the stock market crashed.

National City’s and NCC’s bonus plans created perverse incentives that encouraged Mitchell and his senior colleagues to pursue ever-greater risks. As Pecora observed, the bonus plans made it “quite easy to understand the reckless, anything-for-a-profit mood in which the National City was operating. The officers had nothing to gain and everything to lose, individually, by a conservative policy.”

The executives knew they would receive only their salary (typically $25,000 per year), without any bonus, if their company earned net profits of less than 8% per year, because all of that amount would go to the shareholders. In contrast, they stood to collect one-fifth of any “superprofits” above 8%, and “there was no possible risk of loss of their own money to deter them.”

In Pecora’s view, National City and NCC gave their leaders “a gigantic, foolproof device for gambling freely with the stockholders’ money, taking huge profits when the gambles won, and risking not one penny of their own money if they lost.” Indeed, as noted above, National City provided interest-free “morale” loans to help its top executives after the stock market crashed, and National City subsequently forgave almost all of those loans.

Mitchell and his colleagues secured additional self-dealing benefits by taking personal stakes in some of NCC’s securities deals. For example, in October 1928, NCC agreed to arrange a large sale of the common and preferred stock of Boeing Air Transport, Inc. (Boeing). Instead of making a public offering, NCC sold the Boeing stock to a “preferred list” of purchasers, which included Boeing.

209. PERINO, supra note 9, at 143-49. Baker, NCC’s president, received over $750,000 of compensation from 1927 to 1929. Like Mitchell, Baker received most of that amount through bonuses from NCC’s management fund. See S. Rep. No. 73-1455, at 206-07.

210. For example, in July 1929, NCC paid interim bonuses to its top executives (including $500,000 to Mitchell) as “advances” based on profits that NCC earned during the first half of 1929. However, NCC did not require Mitchell or other recipients to repay those “advances” after the stock market crashed in October and wiped out their bonus entitlements for the full year. PERINO, supra note 9, at 148-49; S. Rep. No. 73-1455, at 205-07.

211. PECORA, supra note 86, at 117.

212. Id. at 117-18; see also PERINO, supra note 9, at 143 (“[P]rofit sharing [for National City executives] did not kick in until the bank had crossed that initial 8 percent threshold.”).

213. PECORA, supra note 86, at 114.

214. See supra note 185 and accompanying text (discussing National City’s “morale” loans).
insiders as well as Mitchell and a group of NCC’s “officers, key men, directors and special friends.”

After completing that sale, NCC publicly advertised that it had sold a large block of Boeing stock to “our own family and certain officers and employees of [Boeing],” and NCC quickly arranged to list Boeing’s stock on the NYSE. NCC’s advertisement was “well calculated to excite the greatest public attention,” and Boeing’s stock price rose sharply as soon as the stock began to trade on the NYSE on November 2, 1928. The immediate rise in Boeing’s stock price produced potential profits of at least $1.6 million for the preferred list of insiders and friends of NCC and Boeing, including Mitchell.

In January 1929, NCC made a second sale of Boeing’s stock, this time through a public offering. In connection with that offering, NCC sold a block of Boeing stock to the same preferred list of insiders and friends (including Mitchell) at a price that was significantly below the public offering price. Those on the preferred list once again received the opportunity to earn substantial immediate profits by selling their Boeing shares into the market.

Albert Wiggin was the “active head and guiding spirit” of Chase and CSC, and he “dominated [both institutions] as overwhelmingly as . . . Mitchell dominated the National City.” Wiggin used his positions at Chase and CSC to reap personal rewards that exceeded even Mitchell’s gains. Chase and CSC paid Wiggin more than $1.3 million in salary and bonuses between 1928 and 1932, and Chase did not require Wiggin to return any of his bonuses after Chase incurred

215. Senate National City Hearings, supra note 20, at 2327 (statement of Joseph P. Ripley, Vice President, National City Co.) (quoting telegram from Charles E. Mitchell, President, Nat’l City Bank of N.Y., to Joseph P. Ripley, Vice President, Nat’l City Co. (Oct. 22, 1928)); see also S. REP. NO. 73-1455, at 107 (describing NCC’s “preferred list” for the sale of Boeing stock).


217. PECORA, supra note 86, at 132-33.

218. Id. at 142-58.
massive losses. In fact, Chase’s board of directors voted to pay Wiggin a lifetime pension of $100,000 per year after he announced his retirement in December 1932, even though Chase and CSC were forced to set aside more than $330 million of reserves against losses between 1929 and 1933. Wiggin received substantial additional payments from directorships that he held in fifty-nine other companies. Many of those companies were clients of Chase and received large loans from Chase.

Wiggin received further self-dealing gains by arranging for his family-owned corporations to participate in many of the trading pools organized by CSC. Wiggin thereby captured for his family’s benefit millions of dollars of profits that CSC could have earned. To ensure that CSC would acquiesce in those arrangements, Wiggin’s family corporations gave director positions, profit-sharing opportunities, and loans to several Chase and CSC officers, who reciprocated by approving the participation of Wiggin’s family corporations in the trading pools. For example, CSC’s massive trading operations in Chase stock produced net profits of only $160,000 for CSC between 1928 and 1932, but Wiggin’s family corporations earned $10.4 million of profits from trading in Chase stock during the same period.

Wiggin suffered probably the greatest public disgrace of any major bank executive during the Pecora hearings when Pecora forced Wiggin to admit that he sold Chase stock short during the stock market’s collapse in late 1929. Wiggin’s family corporations made short sales of 42,506 Chase shares between September 23 and November 4, 1929, covered those short positions on December 11, 1929, and earned net profits of $4 million. Wiggin did not inform Chase or CSC that he was selling short, and he knew that CSC was

223. See id. at 209-10.
224. PECORA, supra note 86, at 145-46; S. REP. NO. 73-1455, at 201-03.
225. PECORA, supra note 86, at 147-52.
227. Senate Chase Hearings, supra note 60, at 2849-54 (statement of Albert H. Wiggin); S. REP. NO. 73-1455, at 188; see also supra Part III.B.2.b. (discussing CSC's trading pools for Chase stock).
228. S. REP. NO. 73-1455, at 188-89; see also Senate Chase Hearings, supra note 60, at 2948-52, 2961-63 (statement of Albert H. Wiggin) (discussing profits earned by his family corporations); PECORA, supra note 86, at 152-54 (discussing Wiggin’s short selling of Chase stock).
actively buying Chase stock during the same time period. Wiggin even had the chutzpah to arrange for two of his family corporations to borrow the necessary funds from Chase so that they could make the necessary purchases of Chase stock to cover their short positions.

Pecora’s exposure of Wiggin’s short selling “thoroughly destroyed [Wiggin’s] reputation.” Pecora also badly damaged Mitchell’s public standing when he forced Mitchell to admit that he had created a fictitious investment loss to shield himself from income tax liability for 1929. Mitchell sold 18,300 shares of National City stock to his wife in late 1929 in order to create a tax loss of $2.8 million, and he bought back the same shares in early 1930. Mitchell relied on the claimed tax loss to avoid paying any income tax on the $1.1 million of compensation he received in 1929. Mitchell’s admission stunned the public and created a “portrait of a greedy banker willing to use any artifice to hang on to every cent of his enormous salary.” Mitchell was tried and acquitted of criminal tax evasion, but he was obliged to pay $1.1 million in back taxes and civil penalties.

In response to the public outrage triggered by Pecora’s revelations, Mitchell resigned as head of National City and NCC, while Wiggin, who had retired as head of Chase and CSC in December 1932, renounced his lifetime pension. The reputations of Chase and National City followed the same downward spiral as those of their fallen leaders. Mitchell’s and Wiggin’s successors, James Perkins and Winthrop Aldrich, announced in March 1933 that they would shut down the securities affiliates of National City and Chase, respectively. Those announcements provided further impetus for passage of Glass-Steagall in June 1933.

229. See Senate Chase Hearings, supra note 60, at 2976-85 (statement of Albert H. Wiggin).
230. Murlyn Corporation and Shermar Corporation, two of Wiggin’s family corporations, borrowed $8 million from Chase in November and December 1929 and used $6.6 million of those funds to purchase 42,506 shares of Chase stock, thereby covering the short positions. Wiggin used additional corporate maneuvers to postpone his recognition of the $4 million profit from short selling until 1931, when he was able to write off that profit against investment losses incurred by Shermar Corporation. S. REP. NO. 73-1455, at 197, 327-28; PECORA, supra note 86, at 155-58.
231. PERINO, supra note 9, at 292; see also CHERNOW, supra note 84, at 356 (describing how Wiggin’s reputation was ruined by Pecora’s disclosure of Wiggin’s short selling).
233. PERINO, supra note 9, at 155-56.
234. Id. at 297-98; Peach, supra note 9, at 595 & n.53.
235. CARROSSO, supra note 9, at 334-35, 346-48; PERINO, supra note 9, at 224-27.
236. CARROSSO, supra note 9, at 347, 371; CHERNOW, supra note 84, at 362; PERINO, supra note 9, at 289; Peach, supra note 9, at 595-97; Perkins, supra note 9, at 523-24.
IV. CONCLUSION

Pecora’s investigation of National City and Chase revealed fundamental flaws in the first-generation universal banking model of the 1920s. National City and Chase were the two largest U.S. banks and operated the two largest and most important securities affiliates. Their performances are therefore highly relevant in considering the question of whether first-generation universal banks posed unacceptable risks to the banking system and the securities market.

As shown above in Part III.B, the evidence produced during the Pecora hearings supported Glass-Steagall’s premise that financial department stores created intolerable hazards that could not be resolved without dismantling the universal banking model. Those dangers included the likelihood that a universal bank would mobilize its deposits, lending resources, and retail branches to underwrite and market high-risk securities to unsophisticated investors who trusted in the bank’s presumed soundness and investment expertise. The universal banking structure also created pervasive conflicts of interest that tempted the bank to (1) make speculative loans and investments to support its securities affiliate, (2) provide risky loans to investors to support their purchases of securities promoted by the affiliate, and (3) extend unsound loans to issuers of securities underwritten by the affiliate.

Conversely, the universal banking model encouraged the securities affiliate to sell unsuitable, high-risk securities to the bank’s depositors and trust customers and to pump up the market price of the bank’s stock by actively trading in that stock. As Ron Chernow pointed out in a 1990 book, the universal banking model allowed banks to “take bad loans, repackage them as bonds, and fob them off on investors, as National City had done with Latin American loans. They could even lend investors the money to buy the bonds.” In addition, if Glass-Steagall had not been enacted, the new system of federal deposit insurance established in 1933 would have aggravated

237. See Wilmarth, supra note 9, at 565-67 (describing arguments made by Senator Carter Glass, Representative Henry Steagall, Representative Hamilton Fish, and Senator Robert Bulkley in support of Glass-Steagall).

238. Id. at 565-68 (discussing the risks of universal banking identified in a 1931 Senate subcommittee staff report).

239. Id.

240. Chernow, supra note 84, at 375.
the risks of universal banking by enabling banks to use subsidized, low-cost deposit funding to support their securities operations.\textsuperscript{241}

Universal banks also generated higher levels of systemic risk by increasing the likelihood that problems in the banking system would spill over into the securities markets and vice versa. Without Glass-Steagall, as Chernow noted, universal banking would have “forced the Federal Reserve System to stand behind both depositors and speculators. If a securities affiliate failed, the [Board of Governors of the Federal Reserve System] might need to rescue it to protect the parent bank. In other words, the government might have to protect speculators to save depositors.”\textsuperscript{242}

To sever any links between deposit taking and the securities markets, Glass-Steagall barred banks from the securities business and also prohibited securities firms from accepting deposits.\textsuperscript{243}

The dangers of universal banking described by Chernow in 1990 were fully realized during the financial crisis of 2007-2009. Large universal banks played leading roles in originating and securitizing hazardous loans and in marketing high-risk, asset-backed securities and related derivatives, which helped to produce the greatest worldwide boom and crash since the Great Depression. To prevent a systemic collapse of global financial markets, government officials in the United States, United Kingdom, and Europe rescued large, troubled universal banks and supported not just their banking units, but also their securities and other nonbanking subsidiaries. Governments also arranged and financed emergency deals that created new universal banks (e.g., Goldman Sachs and Morgan Stanley) and that enabled existing universal banks (e.g., JPMorgan Chase Bank and Bank of America) to become even larger by acquiring troubled securities firms. As a result of those far-reaching government measures, we now have a too-big-to-fail policy that is widely believed to cover not just the banking system, but also large segments of the securities and insurance markets.\textsuperscript{244}

\textsuperscript{241} Id. at 374.

\textsuperscript{242} Id. at 375.

\textsuperscript{243} Wilmarth, supra note 9, at 564-68, 588-91, 616 n.8 (describing the terms and purposes of Glass-Steagall).

\textsuperscript{244} For my own analysis of these events, see Wilmarth, supra note 1, at 989-1050; Arthur E. Wilmarth, Jr., A Two-Tiered System of Regulation Is Needed To Preserve the Viability of Community Banks and Reduce the Risks of Megabanks, 2015 MICH. ST. L. REV. 249, 256-76; Arthur E. Wilmarth, Jr., Citigroup: A Case Study in Managerial and Regulatory Failures, 47 IND. L. REV. 69, 90-132 (2014); and Arthur E. Wilmarth, Jr., The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-To-Fail Problem, 89 OR. L. REV. 951, 957-86 (2011).
As policy makers ponder the need for additional financial reforms, they should reconsider the lessons of the Great Depression, as well as the wisdom of the financial regulatory regime created by Glass-Steagall and other New Deal measures. For example, John Kay, a prominent British economist, has argued that the United States, United Kingdom, and other developed nations should establish regulatory regimes that create clear structural barriers (similar to those prescribed by Glass-Steagall) between traditional banking, securities underwriting and trading, and asset management. Otherwise, he contends, we will never overcome the pervasive conflicts of interest, excessive risk taking, and systemic crises that are inevitable byproducts of financial systems dominated by universal banks.\textsuperscript{245} I intend to show in future work how we could accomplish a fundamental structural reform of our financial system along the lines advocated by Kay.