Exposed by Pecora Commission

Depositors Were Duped To Become 'Investors'

by Paul Gallagher

April 2—The extraordinary "Pecora Hearings" of the U.S. Senate Banking Committee ran from late 1932 through 1933, exploding "bankster crimes" into the knowledge of millions of angry Americans, and leading directly to the passage of the Glass-Steagall Act in 1933.

While other stages of the hearings became more celebrated in later years (the questioning of J.P. Morgan, for example), it was the case of the nation's largest commercial bank, National City Bank, which generated the broad outrage that drove through Glass-Steagall reform.

Just as Bankia and other Spanish banks have notoriously done from 2010 to 2013, National City had duped its depositors into becoming its "investors," and had gotten them to move their deposits into stock of National City itself, and into stock in which its investment division, National City Co., was speculating.

The depositors then, from 1930 to 1932, lost big.

The Senate Banking Committee's report, released on June 6, 1934, started with "The Nature of Commercial Banking," stating flatly, "A sharp line of demarcation should exist between the function of the commercial banker and the investment banker." National City Bank not only violated that line, it filled its own bank branches around the country with securities sales booths of National City Co., and turned its commercial bank employees into stock salesmen competing for bonuses for delivering depositors to the investment arm.

Two Million Shares

Most of Senate special investigator Ferdinand Pecora's many hearings had already been devoted to showing the huge role of commercial banks like National City Bank, from 1926 to 1929, in lending their deposit base into securities bubbles, securities pools, firms, and making brokers' loans to carry speculation in stocks, bonds, and more exotic instruments. With National City executives and CEO Charles E. Mitchell, who was disgraced by the hearings, Pecora showed how depositors were personally thrown into the sheep dip of stock speculation, and then sheared, all by the National City Bank.

The June 1934 Senate report, under the heading "Violation of fiduciary duty to depositors and investors," stated:

"Commercial banks found a fertile field among their depositors for purchasers of security issues which their investment affiliates were sponsoring. These depositors were sold securities in which the [bank] affiliates had a pecuniary interest.

"Not only did the managers and employees of the banks recommend depositors as prospective customers to the salesmen of the investment companies, but bank employees directly sold bank securities to customers, the branch banks receiving a service allowance for such sales."

And under the heading, "Trading and pool operations in the capital stock of commercial banks by investment affiliates," the report summed up the admissions of National City Bank officers under Pecora's relentless questioning:

"Commercial banks used their investment affiliates not only to circumvent the law forbidding banks to purchase and sell their own capital stock, but to participate in speculative ventures in their capital stock.... Commencing in 1928 the National City Co. started a vigorous, extensive campaign for the sale of the capital stock of National City Bank, which encompassed not only depositors and the public, but the bank's employees.... It sold approximately 1,950,000 shares of the bank stock at an approximate cost of $650,000,000 to the public. The National City Co. encouraged its salesmen to 'switch' the public, including National City Bank depositors, to National City Bank stock."

In a particularly nasty practice, National City Bank officers and insiders used depositors to pump up the sales of other stocks in which they were speculating, and then sold out for profits, leaving the downside of the stock bubbles to the depositors, "the mickeys."

The Banking Committee's final report stated that the Banking Act of 1933, known as the Glass-Steagall Act, was thus passed to stop thse practices by total bank separation: "The Banking Act of 1933, enacted on June 16, 1933, was promulgated to effect a complete severance of the commercial and investment banking functions, and to eradicate many of the abuses disclosed at the hearings before the Senate."