

# **The Investment Company Act of 1940: Democratizing Finance in the Fight Against Fascism**

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## Introduction

*Hearings before a Subcommittee of the Committee on Banking and Currency;  
A Bill to Provide for the Registration and Regulation of Investment Companies and Investment Advisers*

Final Statements – June 4, 1940

Senator Downey: “Do I understand that the representatives of the investment trusts and of the Securities and Exchange Commission are virtually in agreement now?”

Senator Wagner: “Not virtually but actually in agreement.”

Senator Downey: “This is a most amazing thing in this chaotic world right now.”

Senator Wagner: “I think it is.”

Senator Downey: “It is really the first encouraging thing I have heard in several weeks. How was this miracle brought about?”<sup>1</sup>

In an unusual sequence of events, the Securities and Exchange Commission worked tirelessly alongside fund managers to make investment companies a safer and more efficient way to allocate capital, which culminated in the passage of the Investment Company Act of 1940. This regulation miraculously came to be in a “chaotic world” where the United States still felt the reverberations of the 1929 Stock Market Crash and witnessed European nations fall to totalitarianism as they faced their own economic and political crises.<sup>2</sup>

By the end of the 1930s, President Roosevelt had the urgent job of solidifying the foundations of American democracy to ensure the nation did not fall to the same fate as Europe. In this time of chaos and crisis, citizens worried that the administration was going to become a totalitarian regime itself and the administration worried that citizens were going to turn to totalitarianism if democracy and capitalism did not adequately serve their purposes. As a response to these fears, FDR and his administration first expanded the government’s bureaucratic control and then regulated the flow of capital through the ‘40 Act, justifying both as critical steps in the fight to save democracy. In a moment when it only seemed logical that the nation would

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<sup>1</sup> U.S. Congress, Senate, Committee on Banking and Currency, *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcommittee of the Committee on Banking and Currency*, 76th Cong., 3d sess., 1940, 1130. [Hereinafter *Investment Company Act Hearings*].

<sup>2</sup> The shorthand for the Investment Company Act of 1940 is the ‘40 Act.

rely on business to win the war effort, expand the economy, and defend democracy, the government stepped in to regulate financing channels. How more government became synonymous with more freedom and more regulation became the central way to achieve more robust markets will be the central focus of this thesis. By examining the new definition of economic citizenship developed by Jerome Frank, the Chairman of the SEC from 1939-41, I will demonstrate how these seemingly contradictory ideas became not only intertwined, but understood as compatible when the nation stood on the brink of war.

FDR and his administration believed that a prosperous economy, supported by government, could guarantee Americans with a basic level of security and preserve democracy. According to Jerome Frank, Senator Robert Wagner, FDR, and other liberal reformers, the way to defeat fascism and defend democracy was through a new form of economic citizenship. All believed that the investment company, properly regulated, could provide power and protection to individual investors, business, and finance, which all working together would help the economy fully realize its potential, and ultimately prevent the nation from falling victim to the dangerous ideologies taking hold in Europe. With the confidence of government oversight and protection, private capital would flow into business, so business could then expand, generate returns on that capital for individual investors, and later help the administration prepare for war. Ultimately this would bind the individual to the corporation and the corporation to government, and secure faith in the inherent value of the American profit system.

Frank's collaboration with Wall Street to craft and pass legislation for these new investment vehicles did not amount to the SEC capitulating to the fund companies, but was a necessary step in the SEC expanding its control over the market. While the SEC compromised on some regulatory matters, the Commission managed to pass the most drastic and contested provisions of

the Act: the SEC shut down the use of leverage and awarded itself discretion over the size of funds. In the end, however, what mattered most to Frank were not the specific regulations that passed, but the institutionalization of a broader radical shift in the way people would come to think about the markets. While during the 1920s, Americans believed that the market was a self-correcting, automatic system that functioned most efficiently without any oversight, by the 1930s government oversight was accepted as essential to ensure efficiency. Frank ushered in his philosophy, experimental jurisprudence, which suggested that seemingly objective systems, facts, and laws that governed society were actually subjective because they were impacted by human decisions. Frank's vision was so revolutionary, as it demonstrated that humans shaped market forces, and thus could intervene to make systems more efficient. By making the Investment Company Act a flexible bill where the SEC would have discretionary power and oversight, Frank created a world where the human actor was a fundamental part of the economic system, representing a radical shift from the long-standing adherence to laissez-faire capitalism.

As totalitarianism spread abroad, citizens learned to not fear government intervention as they internalized FDR's central argument: Americans could only feel free if they knew they were strong and a partnership between government and private interests would help realize this strength.<sup>3</sup> The measures of the Act that emerged from working with fund companies were not seen as a cession of power, but as an exercise in the democratic process that relied on the active participation of the citizenry, business, legislators, and judges to put forth as much research and fact-finding as necessary to craft reforms that would benefit the greatest number of actors possible. The threat of war and totalitarianism provided urgency to pass the Investment Company Act, as Frank believed that in order to save democracy and "avert the alternative disasters of

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<sup>3</sup> Franklin D. Roosevelt, "Message to Congress on the Reorganization Act," (April 25, 1939), *The American Presidency Project*. <http://www.presidency.ucsb.edu/ws/?pid=15748>.

chaos and tyranny,” a flourishing profit system, secured by the government, was a necessary precondition.<sup>4</sup>

Since their inception during the 1920s, investment companies provided a way for Americans to exercise their citizenship – purchasing shares amounted to claiming a stake in the nation’s future.<sup>5</sup> Managers promised that the funds could save democracy in the wake of growing corporate power, as they distributed ownership and provided ordinary Americans an opportunity to participate in the age of optimism.<sup>6</sup> Investment companies encompassed a range of financial vehicles at this time: open-end and closed-end funds, which given their relative importance will be the focus of this story, holding companies, and fixed and semi-fixed trusts.<sup>7</sup> In general terms, an open-end fund is a co-mingled investment vehicle where the fund issues unlimited shares that investors can sell at the end of any given investment day based on the net asset value of the underlying securities. A closed-end fund is also a pooled investment vehicle, yet has a fixed number of shares that redeem not at the fund’s net asset value, but according to market supply and demand forces. Because closed-end funds trade at a premium or discount to their net asset value, they let investors speculate and try to time the market as a means to get rich quick.<sup>8</sup> In the 1920s, both of these vehicles, now colloquially known as mutual funds, provided the average

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<sup>4</sup> Town Meeting of the Air, “Can Business and Government Work Together Today?” December 11, 1939; Group No 222, Series VI, Box 175, Folder 712; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

<sup>5</sup> Julia C. Ott, *When Wall Street Met Main Street: The Quest for an Investors’ Democracy* (Cambridge: Harvard University Press, 2011), 177.

<sup>6</sup> Ott, *When Wall Street Met Main Street*, 210; Natalie R. Groh, “The ‘Boston-Type Open-End Fund’ Development of a National Financial Institution: 1924-1940” (PhD diss., Harvard University, 1977), 113-117.

<sup>7</sup> For greater detail on the definition of investment company, see *Investment Company Act of 1940*, 76th Cong., 3d sess., *Congressional Record*, 68: 3756. [Hereinafter *Investment Company Act of 1940*].

<sup>8</sup> Groh, “‘Boston-Type Open-End Fund,’” 179. When a closed-end fund trades at a premium, the price an investor pays for it is higher than the value of the underlying securities that comprise the fund – the net asset value. When a closed-end fund trades at a discount, the price an investor pays for it is lower than the value of the underlying securities that comprise the fund. Many factors influence price which is a result of supply and demand forces – these include: investor perception of the market, the fund’s yield, the fund’s management, and the need for liquidity.

investor the opportunity have top investment professionals manage and diversify their savings by pooling their money in a fund.<sup>9</sup>

Investment companies attracted capital at a rapid pace from 1928-29, with active investors increasing almost nine-fold.<sup>10</sup> The Independent Bankers Association noted that, “Probably no type of American corporation has ever gained success on such a scale in so short a time.”<sup>11</sup> By 1929, investment trusts had rapidly and firmly “taken hold of the financial community.”<sup>12</sup> Buying on credit and speculating in the market allowed Americans to get invested and to get rich, yet also exposed them and the investment companies they invested in, to a tremendous amount of risk. John Kenneth Galbraith deemed investment trusts, “the most notable piece of speculative architecture of the late twenties” into which investors put their unfailing faith while ignoring real dangers.<sup>13</sup>

When the market crashed, the very fund companies that promised to grow billions of assets under management and to bolster American democracy lost an extraordinary amount of investor’s capital. From 1929-32, total assets declined from \$8 billion to \$2 billion and assets in open- and closed-end funds declined from \$3 billion to less than \$1 billion.<sup>14</sup> While declining asset prices played the most significant role, buying on margin and speculation exacerbated

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<sup>9</sup> The leaders of the open-end and closed-end companies played the most significant role in shaping the Investment Company Act, as the stakes were highest for these two types of funds. Thus, this paper will focus largely on these companies and the key players within them. Closed-end funds initially had more assets under management than open-end funds, but after the crash when many of the losses were in closed-end funds, open-end funds started to gain more traction. For more detail on investment trusts, see John Kenneth Galbraith, *The Great Crash, 1929* (Boston: Houghton Mifflin Harcourt, 2009), 46-56.

<sup>10</sup> Groh, “Boston-Type Open-End Fund,” 119.

<sup>11</sup> Groh, “Boston-Type Open-End Fund,” 114.

<sup>12</sup> “Investment Trusts,” *The New York Times*, August 4, 1929.

<sup>13</sup> Galbraith, *The Great Crash*, 46, 56.

<sup>14</sup> Groh, “Boston-Type Open-End Fund,” 220. Open-end and closed-end funds comprise “investment management companies proper.”

losses, as did rampant fraudulent practices. Widespread abuses threatened the confidence of investors and the efficient function of the market.<sup>15</sup>

While no federal financial regulation of securities existed before the New Deal, the onset of the Great Depression coupled with widespread abuses in the financial industry allowed FDR to pass significant legislation in the beginning of his first term. First, the Securities Act of 1933 shifted regulation of securities from states to the federal government in the effort to reduce fraud. The Act mandated that companies submit a public prospectus disclosing business and management information. A year later, the Securities Act of 1934 added transparency provisions for companies requiring further disclosure and audit requirements. The 1934 Act also authorized the formation of the Securities and Exchange Commission to act as a regulatory body and oversee the proper implementation of the Securities Acts.<sup>16</sup> While these financial regulations passed soon after FDR's election, the remaining question was what to do not just with individual securities, but also with entire investment companies that were in charge of safeguarding and growing the savings of every day Americans. The Investment Company Act of 1940 provided a response to this question, yet not until eleven years after the crash.<sup>17</sup>

The Investment Company Act of 1940 has not been a central focus for New Deal or economic historians, whereas the 1933 and 1934 Acts receive immense scholarly attention. Perhaps the quick passage of the 1933 and 1934 Acts suggested that these regulations were the most instrumental for protecting future abuses, rather than the Investment Company Act, which

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<sup>15</sup> Groh, "“Boston-Type Open-End Fund,”” 180.

<sup>16</sup> Other significant financial regulations enacted by FDR's administration included The Banking Act of 1933 otherwise known as Glass-Steagall Act, the Trust Indenture Act of 1934, the Public Utility Holding Company Act of 1935, The Maloney Amendment of 1938 to the Securities Exchange Act, the Chandler Act of 1938, and the Trust Indenture Act of 1939.

<sup>17</sup> Section 30 of the Public Utility Holding Company Act of 1935 directed the SEC to conduct a study of Investment companies and deliver a report and a list of recommendations to Congress. This report collected information via questionnaires, field studies, conferences with investment trusts, and public questioning. See *Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935*.

came much later. More significantly, there is a prevalent historical argument that by 1940, reform efforts ostensibly ended: allegedly, Europe's fascist takeover diverted time and resources from reform to war preparation and also convinced Americans that FDR's administrative state contained the seeds of totalitarianism itself, bringing FDR's entire agenda under immense scrutiny.<sup>18</sup> These historical biases have led historians to discount the administration's agenda at the end of the New Deal, thus narrowing the frame of historical inquiry. When scholarship does address the '40 Act, it is mainly from the perspective of the fund companies. After 1940, the fund industry experienced an explosive influx of capital – in 1940, total net assets in mutual funds amounted to \$450 million in 68 funds and by the end of 1970, that number increased to \$47.62 billion in 361 funds.<sup>19</sup> Given that historians believe the administration's agenda was undermined by this point, it is only logical to study the motivation of fund leaders involved in crafting the legislation that catalyzed this unprecedented private sector growth.

Leading mutual fund historians Natalie Groh, Matthew Fink, John Morley, and Michael Yogg all argue that the fund companies led the way in shaping and championing their own regulation.<sup>20</sup> The passage of the Investment Company Act is attributed to fund leaders whose persistent and collective efforts saw the reform to completion in a political and international atmosphere that supposedly took the country's resources and attention elsewhere. These historians champion the "End of Reform" narrative: each states similar historical circumstances which brought the New Deal to an end and halted any effort to implement reform at the end of

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<sup>18</sup> Reuel Schiller, "Reining in the Administrative State: World War II and the Decline of Expert Administration," in *Total War and the Law: The American Home Front in World War II*, eds. Daniel R. Ernst and Victor Jew (Westport: Praeger, 2002), 188.

<sup>19</sup> Investment Company Institute 2016 Investment Company Fact Book, 72 fig.1, *available at* 172, [https://www.ici.org/pdf/2016\\_factbook.pdf](https://www.ici.org/pdf/2016_factbook.pdf). By the end of 2015, total assets reached \$15 billion in 8,116 funds.

<sup>20</sup> See Michael R. Yogg, *Passion for Reality: The Extraordinary Life of the Investing Pioneer Paul Cabot* (New York: Columbia University Press, 2014); John Morley, "Collective Branding and the Origins of Investment Fund Regulation," *Yale Faculty Scholarship Series Paper 4832* (2012): 31, [http://digitalcommons.law.yale.edu/fss\\_papers/4832](http://digitalcommons.law.yale.edu/fss_papers/4832); Matthew Fink, *The Rise of Mutual Funds: An Insider's View*, 2nd ed. (New York: Oxford University Press, 2011).

the decade. Natalie Groh, among the first to provide an in-depth study of fund companies, addresses the passage of the Investment Company Act in her Harvard dissertation. On this matter, she concludes that the administration did not have the political capital or any incentive to push financial regulation through: “The heyday of the New Deal was over; the national mood was no longer in favor of radical reform legislation. By 1940, the nation and Congress were more concerned with matters of national defense than with the reform of investment trusts which belonged, it seemed, to another era and no longer had urgency.”<sup>21</sup> Yogg, Morley and Fink argue this thesis almost exactly – each points to political momentum moving away from New Deal reform, the public becoming more conservative, the SEC coming under attack, and war approaching as reasons that the administration could not possibly have played a large role in ushering in this reform.<sup>22</sup> By focusing solely on the fund companies’ role in pushing the legislation through, all these historians leave out an examination of any legitimate goals of the administration.<sup>23</sup>

The scholarship that focuses on the SEC itself only provides a cursory explanation of the passage of the ‘40 Act, while examining the other legislation in detail. For example, Ralph De Bedts’ work *The New Deal’s SEC: The Formative Years*, delves into the political and economic climate that produced the 1933, 1934, and 1935 Acts, while only mentioning the ‘40 Act twice.<sup>24</sup>

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<sup>21</sup> Groh, ““Boston-Type Open-End Fund,”” 540.

<sup>22</sup> Fink summarizes his argument: “Had the industry opposed congressional action, it is likely that legislation would not have been enacted. By 1940, the New Deal had run out of steam, the SEC was under attack, and the nation was focused on the war in Europe and American defense preparedness.” Fink, *The Rise of Mutual Funds*, 33.

<sup>23</sup> Though all in accord with the “End of Reform” narrative, these historians differ regarding why the fund companies lobbied for this legislation. Groh views the companies in a more passive role, arguing that the companies knew reform was coming and was also somewhat necessary, so instead of attacking legislation, they limited reform by sponsoring the bill and ensuring the version represented a compromise rather than unquestioned reform handed down by government. Fink argues that open-end fund companies used tax law and legislation as a means to craft a competitive advantage against incumbent closed-end funds in the race to capture assets. Morley, on the other hand, believes that the industry did not support the bill to just prevent more drastic measures or to make a distinction between fund types – instead, he argues that because the public viewed the industry as a whole, individual fund companies wanted to restore the general industry image and used the Investment Company Act as a means to build a new collective brand.

<sup>24</sup> Ralph De Bedts, *The New Deal’s SEC: The Formative Years* (New York: Columbia University Press, 1964), 192-93. Unlike Seligman, however, De Bedts looks at back at 1940 with a sense of optimism, noting that the SEC was able to

The most comprehensive work on the SEC, Joel Seligman's *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance*, only dedicates about ten pages to the '40 Act, yet provides a much more comprehensive picture of the legislative battles around the 1933, 1934, and 1935 Acts. On the '40 Act, Seligman notably declares the Investment Company Act as one of the SEC's biggest failures. He argues that the SEC ceded almost all power to the fund companies in an attempt to pass a minimum amount of regulation before the war and before the election of a new Congress that would likely block the Act, thus doubling down on the "End of Reform" narrative.<sup>25</sup> A review of the Investment Company Act historiography reveals an important gap: while a day by day account of the Act's passing exists from the perspective of the fund companies, there is not a detailed account of the administration's motives, viewpoints, or actions, leaving an untold account of the domestic and global factors that shaped this Act.

This thesis is based on archival research from the Franklin D. Roosevelt Library, which reveals the missing half of the Investment Company Act narrative from the administration's perspective. Daily memorandum and letters from the end of the 1930s sent back and forth between FDR, the SEC, war preparation offices, and the business community reveal that the

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consolidate its power amidst years of backlash and become the supervisor of finance with public understanding and acceptance.

<sup>25</sup> Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance*, 3rd ed. (New York: Aspen Publishers, 2003); Unlike Seligman, De Bedts looks at back at 1940 with a sense of optimism, noting that the SEC was able to consolidate its power amidst years of backlash and become the supervisor of finance with public understanding and acceptance. For another more optimistic, yet cursory take on the Act, see Mark Roe's work where he views the '40 Act as a triumph of the administration in turning populist sentiment into law. Roe argues that the fund industry did not have the political capital to champion or challenge legislation. Instead, the government used financial regulation in a symbolic fashion to create a sense stability during the New Deal by breaking up concentrated power on Wall Street. While Roe provides a new thesis, he, like his contemporaries, does not examine the political and economic climate that made the passage of the '40 Act unique. Mark Roe, "Political Elements in the Creation of a Mutual Fund Industry," *University of Pennsylvania Law Review* 139, no 6 (June 1991): 1469-1511, <http://www.jstor.org/stable/3312388>. Finally, see *Story of Investment Companies* where Hugh Bullock praises the SEC for bringing fund companies under federal regulation, yet describes the describes the final bill that passed as a "conservative effort on the part of the SEC." Hugh Bullock, *Story of Investment Companies* (New York: Columbia University Press, 1959), 77-78.

administration linked the pending financial regulation to war preparation, as it shaped a new vision of economic citizenship. These documents highlight the immense stake the administration had in shaping the Investment Company Act as war inched closer to home, which challenges the prevailing argument that war undermined and detracted from the administration's reform efforts. This thesis is also unique in that it does a close read of Jerome Frank's letters, manuscripts, and speeches stored at Yale's Manuscripts and Archives to connect Frank's philosophy of experimental jurisprudence to his new vision of economic citizenship that he institutionalized in the '40 Act. Not only do the FDR Archives and the Jerome Frank papers allow a new narrative to emerge by using sources historians have neglected thus far, the depth and scope of the contents allow this thesis to explore the global context of the New Deal, reflecting a recent move in the New Deal literature.

This paper will focus on World War I, the Great Depression, and World War II to examine how citizens and the government have negotiated an expanded federal role in times of global crisis. World War I first spurred government involvement in business and societal planning on an unprecedented level. The belief that war was a short, temporary experience allowed for a disruption of adherence to free market individualism. Yet, when war ended, Americans wanted business to function freely and for government to again play a limited role. By World War II, however, Americans had an altered conception of war – preparing for war did not mean preparing for a short-term victory, but for an extended peace. Regulators agreed with Frank's position that there was no point in fighting fascism unless America remained a democracy, so the way the country would have to win the war was through democratic means that led to democratic ends.<sup>26</sup> The war abroad made it clearer than ever to FDR's administration that democracy and the American capitalist system had to be strong as a symbolic front against Nazism and also as a

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<sup>26</sup> Jerome Frank, *If Men Were Angels: Some Aspects of Government in a Democracy* (New York: Harper, 1942), 15.

concrete reality to ensure citizens championed the nation's war effort by providing capital to fund vital war industries. Placing the Investment Company Act in a global, rather than strictly domestic context, captures the Act's full importance to the American people: as America inched closer to war, newly regulated investment companies provided a way for each American to have a stake in saving democracy, in strengthening the capitalist system, and in betting on the future of the nation. By giving attention to Europe's totalitarian fall, I will highlight how the collapse of democracy was a pressing concern of FDR's administration, which shaped, legitimated and gave momentum to government reform and administrative oversight.

After the crash, FDR understood that the government had to intervene to prevent citizens from turning away from democratic and capitalist principles. The 1933 and 1934 Acts were the first attempt to resuscitate the economy and restore faith in the market. Yet, this legislation was ultimately not enough to fuel the economy. By focusing too narrowly on these regulations, historians have missed the fact that the Investment Company Act of 1940 was the key legislation that not only helped spark the economy, but that shaped the nature of government participation in business and finance for decades to come. While the SEC did not win every short-term battle to get each detail of regulation it proposed passed by Congress, it won the ultimate war by making investment companies a federally regulated industry with the SEC as the sole overseer. While some historians interpret the failure to enact strict regulations in the short-term as evidence of the "End of Reform," I will argue that this misses the main point of the New Deal, which was to bind the citizen and state in a new synergistic relationship, and also misses the purpose of Frank's philosophy, which was to institutionalize a space for the SEC to help the market more fully realize its potential. That the final bill represented a compromise between government and business on behalf of the investing public was a testament to the way that Americans had re-

conceptualized what it meant to be a democracy: this involved securing a strong partnership between government and business that championed cooperation, compromise, and fact-based deliberations to usher in a new vision of economic citizenship in a world tilting towards fascism.

These newly regulated investment companies, known colloquially as mutual funds, became the most important and ubiquitous way for Americans to invest in the future of the nation, and thus have defined and shaped the past near century of American finance. Jerome Frank played a critical role in selling the importance of these vehicles to the American public – by articulating of his legal theory and his plan to save democracy, Frank mitigated the nation’s fear of central control and won the bipartisan support of government officials and the citizenry during a time fraught with conflicting ideas about how to save the nation. While soon after World War I, Americans demanded the restoration of the free market and for the government to again play a limited role, by the end of the New Deal, citizens looked to the government as a permanent fixture in American life.<sup>27</sup>

## **I. America in Emergency – World War I & The Great Depression**

Wrongdoing in business, whether it is outright fraud, stifling competition, or misleading the public, threatens American values. If the survival of democracy is predicated on a functioning and fair capitalist system, big business, small business, and all types of investors need assurance that the market does not disadvantage anyone. Paradoxically, strict adherence to the American traditions of individualism and competition has prevented government from implementing reforms that would protect those two very things. The prospect of government reform is often met with fear of centralized power and the desire to maintain an unencumbered free market.

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<sup>27</sup> Barry D. Karl, *The Uneasy State: The United States from 1915 to 1945* (Chicago: University of Chicago Press, 1985), 120.

Times of crisis, however, are unique openings for the government to assert itself in private life. World War I provided the first opportunity for government to create a partnership with business. While this partnership proved pivotal during war, it broke apart in peacetime when the sense of crisis dissipated. Business again functioned unregulated, as Americans wanted government to recede from private life. Around a decade later, the free reign of business proved to harm the American people and by doing so, destroyed the ideals of individualism, competition, and limited central control that Americans adhered so strongly to. The 1929 Stock Market Crash, followed by the Depression provided an opportunity for government to assert its role more strongly than it did during WWI because this time, all Americans faced the crisis at home and felt a greater sense of danger as events unfolded abroad.

Starting in the beginning of the twentieth century, there was a trend toward bigness in business: monopolies threatened to dominate industry, wipe out competition, and stifle innovation, while big business threatened the average American worker. Captains of industry were accused of sacrificing the good of many for the good of a few – political corruption, bribery, exploitation of labor, and price fixing were just some of the many illegal practices they were charged with.<sup>28</sup> Muckraking journalists investigated and chronicled the abuse of power in business – as a pioneer, Henry Demarest Lloyd took on John D. Rockefeller’s Standard Oil Trust. In *Wealth Against the Commonwealth*, Lloyd wrote, “Liberty produces wealth, and wealth destroys liberty... Our bignesses [sic] – cities, factories, monopolies, fortunes, which are our empires, are obesities of an age gluttonous beyond its powers of digestion.”<sup>29</sup> Specific entities were not the enemy – bigness itself was.

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<sup>28</sup> “The Debate over Big Business,” Digital History, [http://www.digitalhistory.uh.edu/disp\\_textbook.cfm?smtid=2&psid=3169](http://www.digitalhistory.uh.edu/disp_textbook.cfm?smtid=2&psid=3169).

<sup>29</sup> Henry D. Lloyd, *Wealth Against the Commonwealth* (New York: Harper and Brothers Publishers, 1898), 2.

When corporations started to grow in the beginning of the twentieth century, Americans had to rethink the foundations of democracy. While owning property used to underlie the traditional democratic ideal, huge corporations now wielded a disproportionate amount of power.<sup>30</sup> Reform movements emerged as Americans wanted to defend the traditional “proprietary democracy,” where ownership of property, and not of stocks and bonds, defined citizenship.<sup>31</sup> Progressives championed state regulation of securities markets to preserve competition and “shore up democracy’s propertied foundations.”<sup>32</sup> Many believed this could be accomplished through disclosure and transparency, granting “Everyman equal access to truthful information.”<sup>33</sup>

Louis Brandeis, American lawyer and Supreme Court justice from 1916-39, channeled American’s growing suspicion of “bigness” in industry and fervently took up the crusade against size in business.<sup>34</sup> Brandeis had a steadfast ideological opposition to disproportionate power in society, no matter the nature or scope, as he believed that powerful bodies threatened individualism.<sup>35</sup> Starting in 1907, Brandeis took on J.P. Morgan as he attempted to create a railroad monopoly in New England, in 1908 he represented the state of Oregon in *Muller v. Oregon* to argue for the protection of female worker’s rights, and then presented ideas for a commission to investigate trusts that would eventually become the Federal Trade Commission. Brandeis published his seminal work, *Other People’s Money and How Bankers Use It* in 1914 to wage criticism against investment funds and investment bankers for concentrating power and unfairly controlling industries. He championed regulation by requiring disclosure mandates,

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<sup>30</sup> Ott, *When Wall Street Met Main Street*, 9.

<sup>31</sup> Ott, *When Wall Street Met Main Street*, 10.

<sup>32</sup> Ott, *When Wall Street Met Main Street*, 27.

<sup>33</sup> Ott, *When Wall Street Met Main Street*, 27.

<sup>34</sup> Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams; Louis D. Brandeis; James M. Landis; Alfred E. Kahn* (Boston: Belknap Press of Harvard University Press, 1984), 84.

<sup>35</sup> McCraw, *Prophets of Regulation*, 106.

famously writing: “Sunlight is said to be the best of disinfectants.”<sup>36</sup> Brandeis agreed with other progressives – disclosure alone could protect investors and prevent fraudulent practices in business and finance.

Amidst Brandeis’ crusade to reign in the power of business, World War I halted his endeavors. In an emergency situation, the government needed to unleash the full power of business: short-term mobilization was more important than exposing “the dark side of big business.”<sup>37</sup> Government looked to business to help America mobilize at a rapid pace and raise capital to fund the war effort. While before World War I, only half of a percent of Americans were invested in the stock market, Liberty Loan drives mobilized more Americans than ever before to buy securities, attracting anywhere from twenty percent to a third of the nation.<sup>38</sup> The government framed ownership of these war bonds as a way to exercise political citizenship and bind the country together in a united front.<sup>39</sup> The New York Stock Exchange, previously under attack, now “positioned itself as the crux of financial mobilization,” as it opened its trading floor for Liberty Loan rallies.<sup>40</sup>

While the war looked like it would suspend a longstanding goal to save the individual from large corporations and risky financial practices, it did provide an opportunity to rethink and reshape the financial system. The presence of an emergency allowed Americans to suspend their distrust of the state and briefly abandon a longstanding adherence to individualism for a sense of community.<sup>41</sup> The crisis of World War I inspired a radical experiment in planning that partnered government and business in the effort to secure the survival of America, its allies and

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<sup>36</sup> Louis Brandeis, “What Publicity Can Do,” *Harper’s Weekly*, December 20, 1913.

<sup>37</sup> McCraw, *Prophets of Regulation*, 126.

<sup>38</sup> Ott, *When Wall Street Met Main Street*, 57.

<sup>39</sup> Ott, *When Wall Street Met Main Street*, 131.

<sup>40</sup> Ott, *When Wall Street Met Main Street*, 53.

<sup>41</sup> William Leuchtenburg, “The New Deal and the Analogue of War,” in *Change and Continuity in Twentieth-Century America*, ed. J. Braeman et al. (Columbus: Ohio State University Press, 1964), 75.

democracy. During the war, America and Europe implemented levels of coordination like never before – as the war required massive mobilization of resources, government had the chance to engage in top-down planning, placing technocrats in charge of what the markets had been in charge of before.<sup>42</sup> While the partnership would necessitate that government stop their crusade into regulating businesses, it also provided an opportunity for both to work together and achieve positive synergies that would benefit the American people and extend into peacetime.

When the war ended, Americans had a completely new relationship with investing – owning securities now had a positive connotation as it allowed individuals to exercise citizenship in a time of urgent need.<sup>43</sup> Many believed that the federal government had to regulate the securities market in order to support and protect these new “citizen-investors.”<sup>44</sup> The increased bureaucratic capabilities of government and the partnership between business and government did not, however, survive into peacetime nor did plans for government to investigate malpractices. While the war provided an opportunity to incorporate government into the financial system, it also gave finance new meaning and new leverage that allowed it to ultimately discredit the importance of government intervention.

The New York Stock Exchange repurposed the government’s conception of an investor driven democracy to serve its own ends. In the beginning of the 1920s, the exchanges transformed the conception of investor citizenship from that of owning state debt to that of investing in corporate stock, creating a theory of New Proprietorship.<sup>45</sup> The exchanges wanted self-governance instead of government oversight, and used mass communication as the government did during the war to build its case. The Exchange legitimated itself and stock

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<sup>42</sup> Lord Salter, *Memoirs of a Public Servant* (London: Faber and Faber, 1961), 105-22.

<sup>43</sup> Ott, *When Wall Street Met Main Street*, 54.

<sup>44</sup> Ott, *When Wall Street Met Main Street*, 115.

<sup>45</sup> Ott, *When Wall Street Met Main Street*, 131.

ownership by criticizing corporations. It argued that capitalism would destroy democracy if citizens no longer owned property, and that stock ownership would be the way to restore “economic democracy in the industrial age.”<sup>46</sup> The new shareholder democracy “urged Americans to renounce the state as an agent for managing economic risk or allocating economic resources,” as it viewed mass investment and government regulation as antagonists.<sup>47</sup>

Warren Harding’s “Return to Normalcy” presidential campaign encapsulated the nation’s desire to decrease the size and influence of the federal government. After the war, Americans and the government believed that the only way for the economy to prosper was with limited federal intervention. Addressing the College of William and Mary in 1926, then President Calvin Coolidge challenged the importance of government, arguing that citizens would not notice the difference “if the Federal Government should go out of existence.”<sup>48</sup> He argued that, “No plan of centralization has ever been adopted which did not result in bureaucracy, tyranny, inflexibility, reaction, and decline.”<sup>49</sup> Coolidge praised limited government, and believed the automatic force of the market was the best way for Americans to achieve wealth.

In the roaring 1920s, businessmen and government officials assured Americans that growth was unlimited, that investments were sound, and that everyone should participate in America’s prosperity. Borrowed money allowed ordinary Americans to capitalize on the age of optimism. Americans purchased equities by putting down only ten percent of the price and used credit to finance the rest. As more and more Americans entered the market using credit, stock prices and confidence soared.<sup>50</sup> From August 1921 to September 1929, the Dow Jones Industrial Average

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<sup>46</sup> Ott, *When Wall Street Met Main Street*, 210.

<sup>47</sup> Ott, *When Wall Street Met Main Street*, 5.

<sup>48</sup> Calvin Coolidge, “Address at the College of William and Mary” (speech, Williamsburg, VA, May 15, 1926), The American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=397>.

<sup>49</sup> Calvin Coolidge, “Address at William and Mary.”

<sup>50</sup> “Stock Market Crash of 1929,” Federal Reserve, <http://www.federalreservehistory.org/Events/DetailView/74>.

skyrocketed six-fold, leading economist Irving Fisher to declare, “Stock prices have reached ‘what looks like a permanently high plateau.’”<sup>51</sup>

While at first, mass investment in stocks was thought of as the way to democratize capitalism, the investment trust emerged as the central vehicle for Americans to gain an “entrepreneurial stake in the entire corporate economy” rather than just in one stock.<sup>52</sup> Trust managers claimed these vehicles in particular would promise an “equitable shareholders’ democracy” that would “tap the ever-certain, ever-expanding wealth of the nation.”<sup>53</sup> Marketers repurposed the language of the War Loans for their own ends. They invited Americans to “Invest in the Prosperity of America!” join “A Partnership in America’s Prosperity” and gain a “Share in America.”<sup>54</sup> These trusts promised to redistribute wealth without state action, mitigate stock market volatility, and make corporate stock ownership an affordable and sound investment, all in the name of preserving individualism in the face of the growing power of corporations.<sup>55</sup> Americans flocked to these trusts, and leaders doubled down on the marketing promises: Fisher claimed the funds were “safeguarding the public” and encouraged the public to allocate capital to these trusts.<sup>56</sup>

With these vehicles, investors could buy on credit and participate in speculative investing en masse. If not for investment trusts, many investors would not have been able to buy securities, as they did not have adequate capital to buy a diversified portfolio.<sup>57</sup> The fact that small investors only had to put down twenty five percent of capital to purchase baskets of diversified securities allowed everyday Americans to participate in the market. Yet, investors bought stocks not based

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<sup>51</sup> Irving Fisher quoted in “Fisher Sees Stocks Permanently High,” *The New York Times*, October 16, 1929.

<sup>52</sup> Ott, *When Wall Street Met Main Street*, 175.

<sup>53</sup> Ott, *When Wall Street Met Main Street*, 177.

<sup>54</sup> Ott, *When Wall Street Met Main Street*, 177.

<sup>55</sup> Ott, *When Wall Street Met Main Street*, 177.

<sup>56</sup> “Fisher Sees Stocks Permanently High,” *The New York Times*, October 16, 1929.

<sup>57</sup> Eugene N. White, “The Stock Market Boom and Crash of 1929 Revisited,” *The Journal of Economic Perspectives* 4, no. 2 (1990): 69, <http://www.jstor.org/stable/1942891>.

on their fundamentals, but based on the belief that their prices would rise in the short-term – speculation became ubiquitous. The spike in trading volume relative to outstanding shares, the rise in exchange listings of new issues, the expansion of brokers, and the quantity of margin trading all pointed to the drastic increase in speculation.<sup>58</sup> Few paid attention, even as the speculative fever and margin purchases led investors to overpay for their stocks. Closed-end fund premiums soared, with funds selling way above their net asset values, leading some economists to believe that that the S&P could have been priced thirty percent above fundamentals in the summer of 1929.<sup>59</sup>

When Hoover came to office in 1929, he did not work to reign in the increasing speculation in the market – following Coolidge’s path, he took a hands off approach. Hoover announced that America was close to ending poverty and celebrated the exuberance of the new era. When warning bells sounded, Hoover only tried to encourage Americans more. On October 24, 1929, the first day of the crash known as Black Thursday, Hoover announced that “the fundamental business of the country is on a sound and prosperous basis.”<sup>60</sup> Even though investment trusts showed signs of dangerous risk, Fisher too encouraged people to continue to invest – he declared: “I believe the principle of the investment trusts is sound... and the public is justified in participating in them with due regard to the character and reputation of those conducting them.”<sup>61</sup> When it became clear that the country was in economic danger, government tried to quell the storm through ineffective measures that included organizing meetings on the state of the economy with business leaders to provide the public with reassurance and setting up the

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<sup>58</sup> Barrie A. Wigmore, *The Crash and Its Aftermath: A History of Securities Markets in the United States* (Westport: Greenwood Press, 1985), 26.

<sup>59</sup> J. Bradford De Long and Andrei Shleifer, “The Stock Market Bubble of 1929: Evidence from Closed-end Mutual Funds,” *The Journal of Economic History* 51, no. 3 (1991): 675-700, <http://www.jstor.org/stable/2122941>. Other metrics such as average peak stock price reaching 30 times earnings per share compared to the average return on equity of 16.5% also suggested that the market was significantly overvalued in 1929.

<sup>60</sup> Galbraith, *The Great Crash*, 106.

<sup>61</sup> “Fisher Sees Stocks Permanently High,” *The New York Times*, October 16, 1929.

Reconstruction Finance Corporation to loan money for relief and investment in public works.<sup>62</sup>

The political culture of limited government assistance led to the failure to address or even recognize the depths of the economic turmoil the country was in.

Amidst calls for the end of poverty, unlimited prosperity, and continued investment in an allegedly infallible market, the truth of the matter was that the business of the country was not fundamentally sound. Economist John Kenneth Galbraith argues that what was so great about the crash was not its magnitude, but that it revealed fundamental weaknesses in the larger economy. Galbraith contends that the unequal distribution of income, risky corporate structures and banking structures, and faulty economic intelligence were all to blame.<sup>63</sup> Although there was not a single causal factor of the Depression, investment companies played a role in the market's downturn.

While trusts promised to safeguard the American public and protect democracy, there was relatively no regulation or oversight of these vehicles. This proved to have detrimental consequences, as it undermined public confidence in investing, and thus threatened the foundation of the new conception of American democracy.<sup>64</sup> Investment companies practiced abuses that exacerbated losses: these included self-dealing, high-pressure sales tactics, pyramid schemes, inaccurate reports to security-holders, questionable capital structures, and blatant fraud where managers stole trust assets and used them for private purposes.<sup>65</sup> Paul Cabot, Board Chairman of the pioneering Boston fund, State Street Investment Company, remarked years after

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<sup>62</sup> Galbraith, *The Great Crash*, 137. When state governments applied for grants from the RFC, they were told to raise taxes. By the end of 1932, the RFC only lent one third of what it was chartered to do – it could not escape the political culture of limited government assistance.

<sup>63</sup> Galbraith, *The Great Crash*, 169. Charles Kindleberger complicates these ideas in his introduction, where he presents varying viewpoints for the factors which caused the Depression. He specifically highlights Milton Friedman's singular causal model and Paul Samuelson's contention that the Depression was a result of several historical accidents. Charles Kindleberger, *The World in Depression: 1929-1939* (Los Angeles: University of California Press, 1975).

<sup>64</sup> Ott, *When Wall Street Met Main Street*, 181.

<sup>65</sup> Chelcie C. Bosland, "The Investment Company Act of 1940 and Its Background," *Journal of Political Economy* 49, no. 4 (1941): 478-79, <http://www.jstor.org/stable/1825203>.

the crash that many trusts “never disclosed their portfolio” and that investors “didn’t know what the hell” they were investing in.<sup>66</sup> The massive investment company losses and abuses proved a point many tried to make years before – ineffective regulation and fraudulent practices would harm the American public.<sup>67</sup>

After investors lost \$3 billion out of \$8 billion invested from 1927-35, and after investment trust’s stocks plummeted, it was clear that inconsistent state oversight and individual caution were not enough.<sup>68</sup> Investment trusts revealed they were not a “built-in defense against collapse,” but “really a profound source of weakness.”<sup>69</sup> The value of these trusts was merely a mirage – people used investment companies to speculate in the market, yet these companies in turn used investor’s capital to finance their own speculation.<sup>70</sup> Given that all the trusts were invested in each other, when one fell, they all fell. Even before the crash, the federal government tried to regulate these investment companies starting in 1911 with “blue sky laws.” These were statutes that mandated certain disclosure requirements for securities sales, which varied state by state.<sup>71</sup> These laws were ultimately flawed, inconsistently applied, and failed to stop major problems in the securities market. Left unchecked, these abuses were dangerous for two reasons: first, they robbed the American public of its money, and second, they deterred investors from risking their capital in the market out of fear that the system was rigged against them. Yet, when it was clearer than ever that the government needed to set the economy on a new course, Americans adhered to

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<sup>66</sup> Paul Cabot quoted in Ott, *When Wall Street Met Main Street*, 181.

<sup>67</sup> In 1928, the Los Angeles Chamber of Commerce created a committee to investigate investment trusts in response to red-flags. While the committee found that the term “investment trust” misled the public as to what they were actually investing in and discovered a lack of legislation and oversight of these vehicles. It ultimately concluded that current state regulation of securities was enough. The committee believed that laws could not protect investors, as the best protection was an individual’s caution and scrutiny. Bosland, “The Investment Company Act of 1940,” 480.

<sup>68</sup> This figure for losses in Investment Companies is contested – it does not take into account dividends and interest received by investors and somewhat arbitrarily defines the time-period during which it values investment trust securities. Nevertheless, the losses suffered were immense. See Bosland, “The Investment Company Act of 1940,” 494.

<sup>69</sup> Galbraith, *The Great Crash*, 122.

<sup>70</sup> Galbraith, *The Great Crash*, 124.

<sup>71</sup> Jonathan R. Macey and Geoffrey P. Miller, “Origin of the Blue Sky Laws,” *Texas Law Review* 70.2 (1991), 349-351, [http://digitalcommons.law.yale.edu/fss\\_papers/1641/](http://digitalcommons.law.yale.edu/fss_papers/1641/).

the same spirit that existed before and after WWI – adherence to laissez-faire capitalism, fear of government intervention, and steadfast belief in self-correcting markets – all which constrained the government’s response to turmoil in the market.<sup>72</sup>

The Great Depression that followed the crash provided the next opportunity for government intervention – the complexity of this crisis and its crippling effects on the lives of Americans enabled government to extend its reach further than ever before. When FDR came to office, he understood the depths and urgency of the financial crisis. He knew that in order to save the country from itself, he would need to re-conceptualize the relationship between citizen and state in order to usher in an age where government could play a role in regulating business.

At first, FDR highlighted the extraordinary nature of the crisis to quickly enact top-down reforms with the aim of bringing about short-term economic relief and correcting the wrongdoings that brought down the economic system. In “The New Deal and the Analogue of War,” William Leuchtenburg argues that New Dealers likened the Depression to war to create the same sense of crisis that would allow government to again foment a sense of collective purpose and position its extended reach as necessary to save the nation.<sup>73</sup> Indeed, at his inauguration, FDR highlighted the connection between emergency and the need for an extraordinary use of power – he stated: “I shall ask the Congress for the one remaining instrument to meet the crisis – broad Executive power to wage a war against the emergency, as great as the power that would be given to me if we were in fact invaded by a foreign foe.”<sup>74</sup> This emergency situation helped FDR fast-track legislation such as the 1933 and 1934 Securities Acts

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<sup>72</sup> The Investment Company study was published in a report to Congress that amounted to 5,300 pages. Under the supervision of Commissioner Robert E. Healy, the SEC investigated over 1,272 trusts over four years and spent over \$500,000 on the investigations. The *Report* is published in *Investment Trusts and Investment Companies: Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, on S. 358, Part 1, April 2-10, 1940.*

<sup>73</sup> Leuchtenburg, “The New Deal and the Analogue of War,” 75.

<sup>74</sup> Franklin D. Roosevelt, “First Inaugural Address,” (speech, Washington, D.C., March 4, 1933), The American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=14473>.

and to create the Securities and Exchange Commission. The market crash provided proof that Americans needed government intervention in the market – faith in self-correction would be replaced with confidence in reform efforts.

Given the nature of the crisis – uncertainty coupled with rapid change – the administration at first highlighted the need to test experimental short-term reforms. Addressing students at Oglethorpe University, FDR stated: “The country demands bold, persistent experimentation. It is common sense to take a method and try it: if it fails, admit it frankly and try another. But above all, try something.”<sup>75</sup> This emergency situation gave government the flexibility to implement new rules in a time of crisis that might have been contested in a different atmosphere. Regarding the 1933 Act, Congressman Cohen remarked to James Landis, the SEC Chairman at the time, that “there was virtually no dissent” regarding the passage of the bill.<sup>76</sup> While the acute sense of emergency allowed government to expand its powers in the short-term, the government had to shift its strategy to continue its long-term plans when the sense of emergency receded.

As economic turmoil continued, temporary relief was not enough – FDR believed the nation needed a more enduring program for reform. While FDR’s war metaphor helped perpetuate the sense of emergency, it also implicitly promised that the government’s response would only be temporary.<sup>77</sup> To justify the increase in power, the administration now had to answer the complex question: “How strong a government was necessary for coping with conditions that some perceived to be historically new?”<sup>78</sup> The SEC wrestled with this question both in peacetime and as the nation inched closer to war.

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<sup>75</sup> Franklin D. Roosevelt, “Address at Oglethorpe University,” (speech, Atlanta, GA, May 22, 1932), The American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=88410>.

<sup>76</sup> Cohen quoted in McCraw, *Prophets of Regulation*, 175.

<sup>77</sup> Karl, *The Uneasy State*, 120.

<sup>78</sup> Karl, *The Uneasy State*, 120.

The SEC began its investigation of investment companies with a mandate pursuant to Section 30 of the Public Utility Holding Company Act of 1935. Although abuses were widely known, the SEC still had a difficult time justifying significant intervention without the same sense of emergency palpable right after the crash. Starting in 1936, the SEC held preliminary hearings with fund companies to investigate their practices and discover wrong-doings. These hearings found SEC representatives “at their most hostile” and industry members “at their most resistant.”<sup>79</sup> William A. Parker, an industry leader and President of Incorporated Investors, called the hearings a “private inquisition” and noted that “the kind of people that were hired by the SEC to make a report of [the industry] were naturally the people who were eager to catch the butterfly and pull its wings off.”<sup>80</sup> Strong dedication to principles shaped the moral crusader mentality of the hearings. Filled with hard-working, aspirational lawyers and academics, the members of the SEC were imbued with a sense of enthusiasm that best encapsulated the spirit of the New Deal.<sup>81</sup> At this point, Wall Street and the SEC did not find any common ground or perceive their goals to be compatible, which led to a “constant and violent clash of ideas.”<sup>82</sup> With a contentious beginning to the study, the turbulence of the following years would seem to bring the entire regulatory endeavor to a halt.

The New Deal coalition faced a number of challenges from within during its second stage: a court-packing controversy, mounting tension from business, a challenging mid-term election, and most significantly, a recession.<sup>83</sup> The 1937-38 recession saw real GDP fall ten percent and unemployment rise to twenty percent. On top of that, industrial production declined thirty two

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<sup>79</sup> Groh, “Boston-Type Open-End Fund,” 496.

<sup>80</sup> William A. Parker quoted in, Groh, “Boston-Type Open-End Fund,” 476.

<sup>81</sup> Groh, “Boston-Type Open-End Fund,” 473.

<sup>82</sup> Letter, Howard S. Cullman to FDR, October 25, 1937; Official File 1060 – Securities and Exchange Commission, Box 9, Miscellaneous 1934-1944; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>83</sup> Historians categorize 1935-38 as the “Second New Deal,” a time when FDR’s administration adopted new positions that emphasized deficit spending in order to put reform on a stronger long-term footing.

percent.<sup>84</sup> Many businessmen and conservatives used this recession to attack government reforms and call for the SEC to roll back stringent regulation. In this climate, where it was unclear if prior New Deal regulation would even survive, passing new regulation seemed improbable at best.

FDR and the SEC faced attacks from politicians and businessmen who argued that new financial regulation tied up capital, causing the drought that led to the recession. Lyle T. Alverson, the former head of the National Emergency Council sent FDR a memo, which stated: “The SEC activities, in protecting stock selling evils, have ended stock selling.”<sup>85</sup> American banker and financier Winthrop Aldrich argued that the SEC was to blame for the recent fluctuations in the market and its regulation was “ruining the nation.”<sup>86</sup> Howard Cullman, Director of the County Trust Company and a former fundraiser for FDR’s New York Gubernatorial campaign, wrote to FDR explaining that while he believed that the SEC was intended to be an independent agency, the failure of Wall Street to embrace reform compelled the SEC “not only to regulate, but to crusade.”<sup>87</sup> He described constant opposition between the SEC and Wall Street and expressed his opinion that the SEC had gone “too far in the direction of regulation which became at times almost punitive rather than constructive.”<sup>88</sup> Members of the financial community believed the administration and the SEC were slowing the economy with regulation and thus did not see potential for alignment with reform efforts.

While Roosevelt did agree that a capital strike caused this recession, he did not believe that relaxing government regulations was the answer. Instead, FDR and Frank believed that creating

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<sup>84</sup> “Recession of 1937-38,” Federal Reserve History, <http://www.federalreservehistory.org/Events/DetailView/27>.

<sup>85</sup> Memorandum to FDR, January 5, 1938; Official File 1060 – Securities and Exchange Commission, Box 9, Miscellaneous 1934-1944; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>86</sup> Memorandum to FDR, October 25, 1937; Official File 1060 – Securities and Exchange Commission, Box 9, Miscellaneous 1934-1944; Franklin D. Roosevelt Library, Hyde Park, New York. Original editorial found in “Aldrich Blames it on the SEC,” *The Daily Times – News*, October 21, 1937.

<sup>87</sup> Memorandum to FDR, October 25, 1937; Official File 1060 – Securities and Exchange Commission, Box 9, Miscellaneous 1934-1944; Franklin D. Roosevelt Library, Hyde Park, New York. Original editorial found in “Aldrich Blames it on the SEC,” *The Daily Times – News*, October 21, 1937.

<sup>88</sup> Letter, Howard S. Cullman to FDR, October 25, 1937; Official File 1060 – Securities and Exchange Commission, Box 9, Miscellaneous 1934-1944; Franklin D. Roosevelt Library, Hyde Park, New York.

more regulations would encourage Americans to invest in a fair market. The administration understood it needed to work with business in a cooperative rather than adversarial manner, to ensure the American people that the government supported industry and those who invested in American corporations.

In December of 1937, FDR nominated John Hanes and Jerome Frank to the SEC – two men that the public viewed as champions of business. The *Times* noted that the “choices please[d] Wall Street.” Charles R. Gay, the President of the NYSE described Frank as impressive, “extremely able” and as “having a fine enthusiasm for public service.” Although considered something of a radical on the left, Frank was popular amongst the Wall Street crowd because of his expressed willingness to work with instead of crusade against business. After being named to the SEC, Frank released a statement describing his vision of the Commission: he explained that he saw the SEC as the “protector of the interests of the public,” which should establish a relationship with the Exchanges that had “the least possible friction, a minimum of red tape and complete candor from all parties.” Frank understood the importance of releasing the money jam while continuing to protect the individual investor – he concluded that he would help “the commission and Exchanges perform their important function of seeking to make capital market operations efficient, practical and thoroughly honest.” Hanes echoed Frank’s statements, remarking that the SEC needed and “desire[d] the cooperation of business and financial community in order to solve their common problems.”<sup>89</sup> This new spirit of cooperation would guide the SEC as it tried to solve the pressing economic problems by redefining economic citizenship as a partnership between government, investors, and business.

Under the Chairmanship of William O. Douglas and with Jerome Frank newly appointed to the Commission, the SEC undertook empirical and quantitative studies to determine the root

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<sup>89</sup> Citations in this paragraph are from, “President Names New SEC Members,” *The New York Times*, December 11, 1937.

causes of the recession.<sup>90</sup> The SEC first had to address the fundamental question of whether the lack of capital in the market negatively impacted the economy and if the SEC's regulatory programs had anything to do with it. The SEC then had to rebuild its relationship with business and finance so both would embrace reform efforts as mutually beneficial.

Jerome Frank took the lead in addressing the root causes of the recession and immediately asked Paul Gourrich, the statistician for the SEC and the Investment Company study to provide a report addressing the question: "Did or did not the lack of capital expansion play a part in the decline?"<sup>91</sup> While Gourrich explained that the lack of capital expansion did play some role in the recession, he believed that it was not the fault of government. Instead, he argued that government should play an increased role in facilitating the flow of capital by underwriting production in joint corporations between government and industry.<sup>92</sup>

While investment bankers and businessmen still believed that SEC regulation strangled capital, some investment company leaders called for greater regulation. Harold Adams, the head of a fund company, wrote to Douglas about the current regulations. He said the sale of unlisted securities – "one of the greatest evils of the security markets" – had not been prevented by current regulation, which only mandated certain registration requirements and penalties. He warned that over thirty thousand salesmen were selling unlisted securities, disguising them as high grade listed securities. He argued that, "The mere registration of certain securities which are also qualified in the various states is not protection to the investor and I have seen great loss sustained in these securities..." As a remedy, he suggested that all securities be listed, which

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<sup>90</sup> William O. Douglas succeeded James Landis as the Chairman of the SEC from August 17, 1937 to April 15, 1939. FDR nominated him to the Supreme Court in 1939, where he served the longest term in history until 1975.

<sup>91</sup> Memorandum, Paul P. Gourrich to Jerome Frank, "Mr. Currie's 'Causes of the Recession,'" May 9, 1938; Group 222, Series III, Box 27, Folder 255; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale. Gourrich's report found that capital investment fell below its average in the latter half of the 1920s and that Americans never recovered the loss of wealth from the Depression.

<sup>92</sup> Report, Paul P. Gourrich, "Underwriting an Increase in National Income: A Project of Recovery," May 9, 1938; Group 222, Series III, Box 27, Folder 255; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

would create new exchanges and jobs, and “safeguard the investing public.” He noted that if these changes were made, the SEC would “suddenly become one of the most important departments of the Federal Government in a really constructive way.”<sup>93</sup> At this point, the SEC adamantly pushed to protect its reforms and keep government involved in business and finance. It would take the urgency of war to allow the SEC to push through new legislation and expand its regulatory reach.

When Douglas stepped down as Chairman of the SEC in 1939 to replace Brandeis on the Supreme Court, he wrote a letter to FDR that gave an update on the Commission’s work and offered suggestions to keep reforms intact. Regarding the Securities Act of 1933, Douglas praised its effectiveness, recognizing the fifteen billion plus securities issuances since the statute passed and citing the prevention of around two hundred and fifty million dollars of fraudulent issuances. He warned against any amendments, arguing they would not help in recovery and “would be disastrous to investor safety and confidence.” Douglas dismissed claims by some in the business community that the Act dried up capital – he believed it created more liquidity in the market by giving investors confidence to invest. As for the 1934 Act, Douglas wrote that there was “no need for alteration of any of its provisions.” Douglas did not have faith in the ability of business to regulate itself and made a case for greater SEC oversight of certain provisions. Given that history proved that neither Wall Street nor the statute could “equally and fairly” administer stocks, Douglas argued that the law should be amended so that it gave the SEC

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<sup>93</sup> Citations in this paragraph are from, Letter, Harold W. Adams to William O. Douglas; June 30, 1938: Official File 1060 – Securities and Exchange Commission, Box 9, Miscellaneous 1934-1944; Franklin D. Roosevelt Library, Hyde Park, New York.

authority to act when necessary.<sup>94</sup> While Douglas did not manage to concentrate power within the SEC this during his tenure, Frank would use the full force of his ideology to do so.

Finally, Douglas wrote that investment trusts needed to be one of three main areas of legislative focus, citing the urgency of regulating these historically dangerous vehicles. He particularly called for the abolishment of margin trading, citing that it did not help the flow of capital nor did it aid investors. Douglas called the investment trust study “one of the most careful and painstaking studies” the SEC undertook. He warned: “The investment trust, at least in the form in which it is organized, has been one of the most defective and dangerous instrumentalities for investors which the 1920s produced.” In order to preserve the trust, Douglas called for “drastic legislation.”<sup>95</sup> Amidst internal and external threats to the New Deal and to the nation, it is clear that the zeal for reform was far from dead. Felix Belair Jr., White House correspondent for the *Times* correctly noted in 1939: “Social and economic reforms have been all but forgotten.”<sup>96</sup> The brief economic crisis allowed Douglas to take a more fervent stance about the role of government in regulating industry.

While Douglas took a hardline on preserving and creating more regulations, FDR had to decide whether his successor should do the same. FDR considered Leon Henderson, a controversial choice to replace Douglas. The *Times* noted that if Henderson was picked, “It would serve notice on Wall Street that the President was unalterably opposed to any major modification of the Federal Securities Regulation.”<sup>97</sup> At this point, there were apparent factions in the New Deal. Walter Lippmann, a political commentator, argued that there were two types of

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<sup>94</sup> Citations in this paragraph are from, Letter, William O. Douglas to FDR, April 12, 1939; William O. Douglas Papers, courtesy Library of Congress, stored on SEC Historical Collection site.

<sup>95</sup> Citations in this paragraph are from, Letter, William O. Douglas to FDR, April 12, 1939; William O. Douglas Papers, courtesy Library of Congress, stored on SEC Historical Collection site.

<sup>96</sup> Felix Belair Jr., “Brain Trust Far From Dead: But New Emergency Brings New Personnel to Meet Changing Contingencies,” *The New York Times*, September 17, 1939.

<sup>97</sup> “Leon Henderson Mentioned as Successor of Douglas as Chairman of the SEC,” *The New York Times*, March 30, 1939.

New Dealers. The “radicals” were mainly interested in curbing the power of business, implementing “restrictive regulations” to limit private initiative, and installing government control over business. The “conciliators” on the other hand, were interested in working with business.<sup>98</sup> Frank was not a radical in Lippmann’s sense, as he believed in unleashing the power of business, rather than limiting it. Yet, Frank was not a conciliator either.

Speaking at the Chicago Bar Association about what type of man should replace Douglas, Frank argued that the chosen administrative officer would have to “detest absolutism.”<sup>99</sup> Frank rallied against the crusader mentality of men like Brandeis who opposed big business at all costs. While financiers may have thought Frank’s openness to business would amount to the SEC capitulating to their demands, this was not at all the case. To detest absolutism meant to introduce more regulators who could adjust laws to best serve the public in changing circumstances. Frank was ultimately appointed to SEC Chair, where he would work with business not to answer their demands, but in the interest of understanding what reforms could most effectively bolster, rather than curb private enterprise. Frank understood the importance of getting investors to inject new capital into the market not just to prevent another recession, but also to strengthen democracy as the threat of totalitarianism grew. This urgent goal necessitated swift and impactful action, which necessarily involved incorporating the input of business.

The possibility of democratic collapse led Frank to secure a relationship with business, which both inspired confidence in investments and afforded the SEC greater regulatory power. In a town meeting in December, the moderator opened by emphasizing the new cooperative spirit felt in American politics. He noted the “shadow of war” looming behind discussions about domestic issues and warned that to avoid Europe’s fate, Americans had to make its democracy function at

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<sup>98</sup> Walter Lippmann, “Conflict Within the New Deal,” *New York Herald Tribune*, May 19, 1939.

<sup>99</sup> “Frank Urges Care in SEC Selection,” *The New York Times*, April 9, 1939.

home by discussing issues in an atmosphere where “justice rather than force [was] the criterion.”<sup>100</sup> Floyd Odlum, one of the wealthiest American industrialists, praised regulation and encouraged business to cooperate with the SEC. He said that business had to be open minded and cooperative, so that the SEC would invite leaders to the conference table to help explain the practical problems of business and formulate sound rules. He argued that regulation was not to blame for the capital strike, and instead blamed “suspicion” and “fear.” He argued that capital could not be “driven” to work, but instead had to be “coaxed,” with “confidence” acting as the “best bait.” The idea was for government and business to work together, which would restore confidence, free up capital, and preserve democracy.<sup>101</sup>

At this meeting, Frank made a point to expand upon the connection between cooperation and the preservation of democracy. Frank explained that the central goal behind the SEC’s cooperation with business was preserving the profit system in the name of preserving democracy. He said SEC’s laws were designed with the prime goal of restoring and maintaining “good faith” between business and potential investors, and noted that without this faith, “the profit system would crack up and democracy would be imperiled.” Frank shaped his remarks with awareness that critics could find issue with the idea of a partnership between regulators and those they were regulating. To mitigate the concern that America was turning into the countries it was trying to defend itself against, Frank highlighted the contrast between the SEC and these regimes: “We, in the SEC are therefore engaged in the task of fortifying the American profit system in the interest of democracy.” Only under this secure profit system, did Frank believe America could “avert the

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<sup>100</sup> Town Meeting of the Air, “Can Business and Government Work Together Today?” December 11, 1939; Group No 222, Series VI, Box 175, Folder 712; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale. Original text published in “Bulletin of America’s Town Meeting of the Air,” Col 5, No 9, *Columbia University Press*, December 11, 1939.

<sup>101</sup> Citations in this paragraph are from, Town Meeting of the Air, “Can Business and Government Work Together Today?” December 11, 1939; Group No 222, Series VI, Box 175, Folder 712; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale. Original text published in “Bulletin of America’s Town Meeting of the Air,” Col 5, No 9, *Columbia University Press*, December 11, 1939.

alternative disasters of chaos and tyranny.”<sup>102</sup> Frank made clear that his regulatory system would not spell the collapse of democracy, but would be the means to ensure its survival – alluding to Europe’s failed governments only created greater urgency for reform.

As early as July 1932, on the eve of FDR’s victory, Benito Mussolini stated: “The liberal state is destined to perish... All political experiments of our day are anti-liberal.”<sup>103</sup> By 1939, the fear of democratic collapse hit its zenith and the nation could have gone in one of two directions: the threat of totalitarianism either would allow the government to take a more significant role in American life to ensure the safety of the nation or it would encourage citizens to take a strong stance against government, in order to protect the nation from also falling to a dictatorial regime. Several historians argue that as Americans became aware of totalitarianism abroad, the threat at home seemed more menacing and made citizens turn against planning and new regulation. As a manifestation of this fear, the *Chicago Daily Tribune* issued a scathing critique of FDR’s plans by comparing his administration to a fascist regime. The editorial argued that the executive rearranged administrations and corporations to gain direct control of them, just as Hitler did in Germany. It declared that the New Deal was “the story of a totalitarian state.”<sup>104</sup>

I will argue, in contrast, that totalitarianism abroad bolstered reform efforts and also motivated administrators to carry out reform in a more democratic manner. In 1939, when the threat of war became more palpable, FDR national and international security making the end goal of both national defense and national agencies the preservation of democracy. In his speech about reorganization in the spring of 1939, FDR addressed the seeming paradox of his argument that a stronger, more centralized government meant greater freedom for the American people. He

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<sup>102</sup> Citations in this paragraph are from, Town Meeting of the Air, “Can Business and Government Work Together Today?” December 11, 1939; Group No 222, Series VI, Box 175, Folder 712; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

<sup>103</sup> Benito Mussolini quoted in Ira Katznelson, *Fear Itself: The New Deal and the Origins of Our Time* (New York: Norton, 2013), 5.

<sup>104</sup> “Our Autocratic State,” *Chicago Daily Tribune*, April 27, 1939.

explained that in order to defeat free states, adversaries of democracies espoused the argument that democracies had to be weak to be truly democratic. He countered this claim arguing, “We are not free if our administration is weak. But we are free if we know, and others know, that we are strong... and that what the American people decide to do can and will be done, capably and effectively, with the best national equipment that modern organizing ability can supply...”<sup>105</sup> The looming threat of WWII did not force the administration to abandon its calls for reform, instead it allowed the administration to expand its vision of security and put reform on a more permanent footing by demonstrating how it was compatible with democracy. The SEC started to speak not only about providing security for the individual investor, but also about securing the nation. In order to do so, the SEC had to ensure three things: first, that its citizens did not panic, lose confidence, and stop investing, second, that the nation could be in a position to deploy a huge amount of public and private capital to industries in the event of US involvement in war, and third, that the way this capital was deployed would serve the nation’s interests in both war and in peace. This time, the financing strategy would be different than it was during WWI: the SEC did not want to enact temporary measures to deal with an acute emergency – instead, the administration took a long-term view and laid down a framework that would help democracy and prosperity endure in the long-term. The way Jerome Frank crafted and shaped the discourse around the Investment Company Act highlighted how the SEC successfully carried out this plan.

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<sup>105</sup> Franklin D. Roosevelt, “Message to Congress on the Reorganization Act.”

## II. A Radical Shift – Jerome Frank’s Experimental Jurisprudence

Jerome Frank left his mark on America’s financial system with the philosophical framework he embedded within the Investment Company Act of 1940. Born September 10, 1889 in New York City to German-Jewish parents, Frank grew up surrounded by law and academia, later forging his own path as a teacher, legal mind, New Deal administrator, and federal judge.<sup>106</sup> Frank attended the University of Chicago and matriculated into its law school following his undergraduate education. After passing the Bar Exam, Frank worked for a corporate law firm in Chicago and New York City. In his early career, Frank was drawn to politics and Freudian psychoanalysis, both which provided an opportunity to develop a multidisciplinary framework for approaching the law. In 1930, Frank gained public prominence after publishing his first book, *Law and the Modern Mind*, which incorporated his multidisciplinary ideas.<sup>107</sup>

Living in New York in the early 1930s, Frank wanted to become more politically active. After FDR’s election, he wrote a note to Harvard law professor Felix Frankfurter, asking for his assistance: “I know you know Roosevelt very well. I want to get out of this Wall Street racket, anyhow. The crisis to me seems to be the equivalent of war and I’d like to join up for the duration.”<sup>108</sup> Frank’s passion and sense of urgency for liberal reform led him to the position of General Counsel for the Agricultural Adjustment Administration and then to the Securities and Exchange Commission and finally to the Second Circuit Court of Appeals. Throughout his career

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<sup>106</sup> Walter E. Volkomer, *The Passionate Liberal: The Political and Legal Ideas of Jerome Frank* (Netherlands: The Hague, 1970), 1.

<sup>107</sup> In *Law and the Modern Mind*, Frank argued that decisions handed down by judges were a product of psychological factors that impacted the particular judge. Frank’s argument was revolutionary – his work “dropped like a bombshell on the legal and academic world.” Walter E. Volkomer, “Frank, Jerome N.” in Roger K. Newman, ed., *The Yale Biographical Dictionary of American Law* (2009), 201-202.

<sup>108</sup> Columbia University Oral History Project, a recorded interview with Jerome Frank on April 11, 1950 in New York City.

as a lawyer and New Deal administrator, Frank's legal and political theories came to the foreground in his six influential and controversial books.<sup>109</sup>

Frank was known as an iconoclast and radical reformer of the New Deal because of his philosophy, experimental jurisprudence, in which he argued that that seemingly objective and neutral facts, laws, and systems are actually subjective and evolving as they are influenced by individual personality factors and biases.<sup>110</sup> This was a radical departure from previously held ideas that systems operated independently from humans. Systems such as the market were thought to act on humans, instead of humans acting on markets as Frank contended. Frank's vision was so revolutionary in that it conferred a tremendous amount of power to the individual to influence the main systems governing American life such as the law and the markets. It also introduced a level of uncertainty into these systems – with no objective facts, the future would be difficult to govern and predict, and thus individuals would become even more important as they would need to continuously interpret facts and shape regulation best suited for a specific point in time.<sup>111</sup> While Frank's beliefs about jurisprudence were radical, his positivist reforming beliefs were consistent with FDR's mandate – Frank believed that practical reform based on fact-finding and judicial procedure could be a powerful bolster to democracy.<sup>112</sup>

Frank used the economic crisis to form a new conception of democratic citizenship that was compatible with his framework of experimental jurisprudence: he encouraged citizens, government, and business all to work together to create experimental reforms to restore agency

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<sup>109</sup> These six books are: *Law and the Modern Mind* (1930), *Save America First* (1938), *If Men Were Angels* (1942), *Fate and Freedom* (1945), *Courts on Trial* (1949), and *Not Guilty* (1957).

<sup>110</sup> Volkomer, *The Passionate Liberal*, 24; Neil Duxbury, "Jerome Frank and the Legacy of Legal Realism," *Journal of Law and Society* 18, no. 2 (1991): 177, <http://www.jstor.org/stable/1410136>; Frank's experimental jurisprudence was regarded as legal realism in the larger legal community.

<sup>111</sup> Jerome Frank, *Law and the Modern Mind* (New Jersey: Transaction Publishers, 2009), x-xi.

<sup>112</sup> Duxbury, "Legacy of Legal Realism," 177.

to the citizenry and pick the forgotten man out of economic turmoil.<sup>113</sup> Given that Frank did not believe in absolutes, he did not designate a certain type of person or practice as the root cause of all evils, like Brandeis did in the earlier part of the century. Such reasoning, Frank believed, would lead to totalitarianism. Instead of targeting the old, Frank believed in the necessity of creating new, experimental structures and policies to adapt to the changing times – in order for new policies to be effective, they would necessitate a meeting of minds between private industry and government. Frank’s ideas were again compatible with the framework FDR laid down: in his Second Fireside Chat, FDR explained that government efforts to restore the economy were not enacted in a totalitarian fashion but were the beginnings of a new partnership between government and the people to ensure the success of democracy.<sup>114</sup> The first attempt to reap the benefit of this partnership emerged in the formulation of investment company reform.

Frank’s investment company reform involved two radical ideas about reform itself: first, that new reform would have a degree of flexibility and discretion worked into the legislation, and second, that reform would be shaped by both government and the private sector. With a menacing totalitarian power looming in the backdrop of American life, Frank had to convince the public that expanding the reach of government and awarding greater discretionary power was not authoritarian, nor was it capitulating to or colluding with business; instead, he argued this vision of reform would bolster America’s democratic process as a bulwark against fascism.

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<sup>113</sup> In 1933, Frank delivered an address before the Association of American Law Schools titled “Experimental Jurisprudence and the ‘New Deal’” – he argued that experimentation was an “imperative necessity” to give the forgotten man the life he deserved. Frank noted that once every man was free from insecurity and secured leisure time, experimentation could recede into the background, although he believed it had “permanent value,” as experimental jurisprudence was both “important” and “useful.” In, Jerome Frank, “Experimental Jurisprudence and the ‘New Deal,’” (speech, Washington, D.C., June 18, 1934), Securities and Exchange Commission Library, <https://www.sec.gov/news/speech/1933/123033frank.pdf>.

<sup>114</sup> Franklin D. Roosevelt, “Second Fireside Chat,” (speech, May 7, 1933), The American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=14636>.

Frank believed that reforms needed to have a degree of flexibility built in, in order to allow individuals to have discretion in adjusting them to best fit changing contexts. In *Fate and Freedom*, Frank explained that Americans could not rely upon fixed economic or social laws given that “change, not permanence” was the new normal.<sup>115</sup> Frank wrote that Americans would face danger if they “project[ed] the impermanent present into an imaginary permanent future,” as the “permanence of the transitory” was merely an “illusion.”<sup>116</sup> In these remarks, Frank implicitly suggested that Americans could not rely on fixed laws to govern future events, so they had to rely on men to adjust these laws. This vision ceded an extraordinary amount of power to the individual to determine the fate of the nation – unchecked power of this nature was precisely what led to totalitarianism abroad and now deeply concerned citizens at home. Yet, this expanded reach and discretion of government were not authoritarian in nature, as Frank demanded that each decision be based on objective procedures.

Frank insisted that investment company regulations, and regulations in general, be based on rigorous fact-finding and the empirical method, rather than on ideology. Frank voiced his support for developing “properly regulated” investment companies to finance small businesses and instructed Gourrich to research the existing state of investment companies and their ability to provide funds to business for the long-term.<sup>117</sup> Gourrich’s subsequent report suggested that small businesses had trouble finding financing, yet did not provide sound data to support his conclusions. Frank responded with a blistering critique of Gourrich’s methodology, or lack thereof, and made a special point to note the current empirical limitations with the investment trust study. Frank then urged the Commission to invest more in fact-finding and data gathering,

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<sup>115</sup> Jerome Frank, *Fate and Freedom: A Philosophy for Free Americans* (New York: Simon and Schuster, 1945), 33.

<sup>116</sup> Frank, *Fate and Freedom*, 33.

<sup>117</sup> Letter, Jerome Frank to Paul P. Gourrich, May 12, 1938; Group 222, Series III, Box 27, Folder 255; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

as he worried that the agency would be de-legitimized if sound statistical methods did not back up each suggestion for reform. In 1939, Felix Belair Jr. picked up on a shift in New Dealer's methods for getting things done in Washington. To meet "new" emergencies, Belair noted that the administration shifted from "trial-and-error" to "time-tested procedure" and from "theory" to "experience."<sup>118</sup> The commitment to basing reform on concrete data afforded the SEC legitimacy and authority in world growing scared of fascism. Unilateral, ideologically informed action from government would fail to reach the most effective outcome and would expose the country to elements of authoritarian rule, whereas greater government intervention, based on rigorous research would bolster democracy by making the market work as efficiently as possible.

As the second radical element of his reform, Frank believed fund leaders and businessmen needed to have a seat at the table to ensure that the SEC had the most information possible to enact appropriate reforms. Working with business would not only help the SEC be more effective regulators, it would also instill confidence in the public that business and government were not antagonists, but had compatible aims. This would inspire greater participation in the profit system and unleash its full potential.

The fact that Frank worked with business to shape reform was neither coercion nor capitulation. Frank believed that the way reform was brought about would necessarily have to be a manifestation of the democratic process at work if these reforms would ultimately lead to a more democratic society. Leaving citizens out of negotiations both would weaken the democratic process and confer totalitarian power to the SEC. Frank believed that a "a willingness on the part of the government and individual citizens to compromise" and "free discussion of governmental

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<sup>118</sup> Felix Belair Jr., "Brain Trust Far From Dead: But New Emergency Brings New Personnel to Meet Changing Contingencies," *The New York Times*, September 17, 1939.

policies” were the keys to perpetuate democracy.<sup>119</sup> While subjects in totalitarian states assumed an infallibility of their leaders, democracies required that the public understand that men were fallible, and thus had the imperative to challenge and work with the government. Frank articulated a plan to restore agency to the individual by encouraging citizens to play a role in shaping their own fate.<sup>120</sup> Working with business was not collusion, but an essential step in realizing this “philosophy for free Americans.”<sup>121</sup> Frank also believed that the “change in social pace” required “new social adaptations” – for Frank, one of the most important adaptations was the new relationship between the private and public sector which would help the government fully understand the complex, constantly changing dynamics of fund companies and the businesses they financed.

Amidst articulating his plan for reform, Frank noted a shift in American’s attitude towards big business. He pointed out that the Temporary National Economic Committee, an investigative body to study monopolies, received very few requests to break up big monopolies and linked this to Americans abandoning “their longing for adventure in favor of a longing for security.”<sup>122</sup> Frank did not believe that the partnership with business would lead to fascism – instead, he believed it would create the most effective reforms that would ultimately bring greater overall security to the American people, something they were desperately searching for.

Frank believed that investment trusts as they stood were not true investment vehicles that provided security for investors. He noted that many Americans used them in the short-term to try to time the market instead of to invest in sound industries, so he wanted to create a more

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<sup>119</sup> Volkomer, *The Passionate Liberal*, 123.

<sup>120</sup> Volkomer, *The Passionate Liberal*, 28.

<sup>121</sup> Volkomer, *The Passionate Liberal*, 28.

<sup>122</sup> Lawrence E. Davies, “SEC Aides Differ on ‘Trust-Busting’: Frank Calls Anti-Trust Fight Futile, Henderson Defends It at Economists’ Session,” *The New York Times*, December 29, 1939.

legitimate vehicle where capital could appreciate over time.<sup>123</sup> The idea for a government financed investment company to aid small business was first proposed, yet Frank disagreed with this idea. He thought that government loans to business would put government too much in control and leave business indebted to government. Instead, Frank and other SEC members wanted citizens rather than government to finance business – this would bind the success of the investor to the success of American industry, allowing everyone to bet on and invest in the future of the nation. In order for these vehicles to make America more democratic, Frank believed they needed to have three essential elements: first, they would prioritize funding to small business, second, they would not categorically limit the power of big business, and finally, they would prioritize equity financing over debt.

First, Frank believed that by prioritizing financing to smaller companies, reform could even out the playing field between small and big business. However, Frank believed that reform should not exclude big business nor should it categorically thwart its power. Drastically departing from Brandeis who was ideologically opposed big business at all costs, Frank did not believe in absolutes, as he argued that the US risked importing totalitarianism if citizens believed in absolute certainty.<sup>124</sup> Frank encouraged the SEC to look at every business and financing decision on a case-by-case basis using objective fact-finding to determine what reforms best served the public interest at the particular point in time.<sup>125</sup> So second, Frank did not want reform to punish big business, as he did not see it as fundamentally antagonistic to individual liberty or democracy if properly regulated.

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<sup>123</sup> Letter, Jerome Frank to Paul P. Gourrich, May 12, 1938; Group 222, Series III, Box 27, Folder 255; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

<sup>124</sup> Volkmer, *The Passionate Liberal*, 130.

<sup>125</sup> Robert Jerome Glennon, *The Iconoclast as Reformer: Jerome Frank's Impact on American Law* (Ithaca: Cornell University Press, 1985), 144.

After establishing that reform should prioritize small business, while still aiding big business, Frank believed that providing equity investment over debt financing for businesses was essential to ensure the long-term success of the American profit system.<sup>126</sup> In a draft of a speech entitled “Bondage to Bonds or Doubts about Debt,” Frank outlined concrete ways an investment vehicle could bolster the economy: he argued that issuing common stock would allow companies to achieve their full potential and would also bind the individual investor to the long-term success of such companies.<sup>127</sup>

“Bonds mean bondage” encapsulated Frank’s central claim: he believed that in an era of rapid technological change, bonds, not stocks, spelled danger for both the individual and the economy at large.<sup>128</sup> In an era where the “one certainty [was] that there [was] no certainty,” too much debt could cripple companies by preventing adaptation.<sup>129</sup> Frank argued that the fixed charges from bond repayments along with high interest left companies “rigidified” when they needed elasticity the most – without the necessary cash, companies would be unable to rehabilitate themselves.<sup>130</sup> Thus, Frank believed bonds were riskier than equities, and determined that that common stock, without any loans or long-term obligations, was the most effective financing mechanism.<sup>131</sup> Just as Frank believed that flexibility would let administrative bodies adequately respond to changing times, he similarly believed that stocks would allow companies to adapt to the complexity of markets by providing a stable pool of capital that did not necessitate short-term repayments. Not only would issuing common stock help corporations grow, it would also bind the fate of individuals with the fate of companies. While bonds only

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<sup>126</sup> “Loan Set-Up Urged for Small Business,” *The New York Times*, February 2, 1940.

<sup>127</sup> Frank, “Bondage to Bonds.”

<sup>128</sup> At this time, many investors and financial professionals believed that bonds were the safe investment and stocks were a gamble.

<sup>129</sup> Jerome Frank, “The Sin of Perfectionism,” (speech, Memphis, Tennessee, October 18, 1940), Securities and Exchange Commission Library, <https://www.sec.gov/news/speech/1940/101840frank.pdf>.

<sup>130</sup> Frank, “Bondage to Bonds.”

<sup>131</sup> Frank, “Bondage to Bonds.”

distribute a yield on an investment and do not allocate a share of profit to investors, stocks allow investors to fully participate in a company's upside as they represent an ownership stake in the company itself. A more robust and prosperous industry coupled with ordinary investors who could profit off of these companies in the long-term would grow and spread the wealth of the nation, and in turn provide a more solid economic basis for democracy to flourish. The backdrop of war only served to provide a sense of urgency that helped Frank fully realize this vision.

In an oral history conducted by Columbia University, Frank recalled that even with the possibility of mobilizing for war, he believed America needed to remain democratic, which meant preventing the concentration of power in the hands of big business. He remarked that he was “very much concerned about the disregard of the economic dislocations and the economic potentialities of the whole defense program.”<sup>132</sup> Frank visited Harry Hopkins, one of FDR's closest aides, when he was sick, “looking like hell, lying in bed” to discuss the defense program and indicate the industries that needed resuscitation and development.<sup>133</sup> Hopkins dismissed Frank's desire for government to partner with business in a time of war, telling Frank: “Look, you've just got to get this nonsense out of your head. It's a lot of New Deal junk. We just can't waste time on any such consideration.”<sup>134</sup> Frank did not waver from his fundamental belief that America had to plan for the preservation of democracy in the long-term, which meant not ceding all power to business, even in the emergency of war. He recalled, “Fundamentally, I was very critical of [Hopkins], because I felt he had needlessly surrendered too much and that he was putting the government altogether too completely into the hands of a small group, the top

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<sup>132</sup> Columbia University Oral History Project, Jerome Frank, 47.

<sup>133</sup> Columbia University Oral History Project, Jerome Frank, 47.

<sup>134</sup> Columbia University Oral History Project, Jerome Frank, 47.

economic group.”<sup>135</sup> Frank believed that surrendering to big business would have totalitarian consequences and tried to remedy this through investment companies that would facilitate the flow of capital into smaller businesses.

With the possibility of involvement in war increasing and the Senate hearings for the Investment Company Act approaching, national security, finance, and cooperation all became more closely intertwined. FDR defined security in broad terms, ultimately blurring the lines between social services, national security, and economic security.<sup>136</sup> FDR’s conflation of domestic and national security provided a foundation for him to organize government policy and allowed agencies to gain more power in American life.<sup>137</sup> Government promised protection of the individual not just by providing basic needs, but also by ensuring investments were sound and the economy allowed for small and large businesses to prosper. The war and finance were linked on both a symbolic and practical level. Symbolically, the government needed to ensure that regulations and restrictions were not enacted in a totalitarian manner, but were a result of a democratic process and agreement between all actors involved. Practically, the new regulatory structures were more important than ever, as they would help finance the war effort. *The New York Times* wrote that the impending trust regulation would help new investment companies fund “new industrial enterprises” and held promise “for injecting new life into the capital market by getting more capital of the risk variety into use.”<sup>138</sup> Opening up capital markets to fund industrial enterprises and important defense industries became a key point of emphasis to justify regulation and the SEC’s increased oversight role.

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<sup>135</sup> Columbia University Oral History, Jerome Frank, 48. In retrospect, Frank noted that he should have been more understanding that the country needed business on its side for quick mobilization – yet, he still believed Hopkins went too far.

<sup>136</sup> Mariano-Florentino Cuéllar, “‘Securing’ the Nation: Law, Politics, and Organization at the Federal Security Agency, 1939-1953,” *The University of Chicago Law Review* 76, no. 2 (2009): 596, <http://www.jstor.org/stable/27793390>.

<sup>137</sup> Cuéllar, “‘Securing’ the Nation,” 604.

<sup>138</sup> “Wagner Bill Seeks Trust Regulation,” *The New York Times*, March 15, 1940.

### III. The Investment Company Act of 1940 – Senate Hearings and Public Discourse

By the spring of 1940, when the war inched closer, government felt an urgency to pass legislation that would free up capital to vital war industries while still keeping the promise to protect the individual investor. In the midst of a looming crisis, Frank believed that, “There [was] no sense in trying to defend America against a foreign dictatorship unless America [was] to remain a democracy.”<sup>139</sup> The newly regulated investment companies would become a means for citizens to contribute to this effort at home. Frank’s version of economic citizenship was not about protecting the individual against large corporations and government control, as it was in the 1920s. Instead, it involved a partnership between private investors and government that worked to channel wealth to various parts of the economy to ensure production was strong, industries were thriving, and employment rates stayed high. Frank believed that if government could ensure that wealth was “dispersed in sufficient quantities to the entire society,” the nation could ultimately “ward off the dangerous extremes of chaos, civil war, and regimentation.”<sup>140</sup> Although many agreed on the urgency of achieving such ends, the regulatory means to do so were contested.

The SEC followed an “unusual procedure” by drafting a bill to introduce before Congress prior to submitting the final study and report on investment companies to federal legislators.<sup>141</sup> Fund managers and legislators objected to this course of action and the *Wall Street Journal* picked up on tensions, reporting that the hearings might well turn into an investigation of the SEC as members of the Senate banking and currency committee planned to scrutinize the SEC’s

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<sup>139</sup> Jerome Frank, *If Men Were Angels*, 15.

<sup>140</sup> Volkomer, *The Passionate Liberal*, 136, 181.

<sup>141</sup> John W. Crider, “SEC Reaches out for Wider Power,” *The New York Times*, March 24, 1940.

policies through cross-examination.<sup>142</sup> As newspapers wrote about potential attacks, FDR's Economic Advisor, Lauchlin Currie wrote him a memo sounding the alarm: "There does not appear to be much point in Wagner holding hearings on investment trusts if these hearings are merely going to be a sounding board for a general attack on the SEC."<sup>143</sup> Fund leaders did indeed challenge the SEC for over-exercising its power. One manager, on behalf of the group, stated: "We deplore the way in which it is possible for federal administrative agencies like the SEC, which properly have no legislative power, to draft legislation and present it fully prepared to Congress."<sup>144</sup> Speaking generally about the administration's regulatory efforts, Republican Senator Robert Taft said that "four-fifths of American business men oppose the present administration because of its 'deliberately unfriendly policies.'"<sup>145</sup> While the SEC did expose itself to criticism for the way it carried out its reforming mandate, given the Act's importance, the SEC decided to hold the hearings.

With tension building between the SEC and the business in response to certain regulations, it is important to recognize that laying down strict, rigid, uncompromising laws was not the desire of the SEC, as it was in opposition to Frank's fundamental beliefs. Frank believed total certainty and would "create within them an attitude of fatalism" that was reminiscent of an authoritarian state – the Commission's job was not to lay down absolute law, but to create a framework where individuals could help shape the direction of business and finance in America.<sup>146</sup> The SEC cared more about laying groundwork for the long-term that would give the Commission discretion and oversight, rather than passing through specific strict regulation in the short-term.

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<sup>142</sup> "SEC Inquiry Likely: Policies and Operations May be Quizzed During Investment Trust Study," *Wall Street Journal*, March 23, 1940.

<sup>143</sup> Memorandum, Lauchlin Currie to FDR, March 25, 1940; Official File 1060 – Securities and Exchange Commission, Box 3, SEC January – March 1940; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>144</sup> Groh, "Boston-Type Open-End Fund," 508.

<sup>145</sup> "Taft Says Business Resents New Deal," *The New York Times*, December 8, 1939.

<sup>146</sup> Frank, *Fate and Freedom*, 204.

Frank shaped the discourse around the Act, emphasizing that the Commission's goal was to help the market fully realize its potential by passing sound regulation based on objective fact-finding, research, and deliberations between government and business. His message resonated both with the public and with members of the Commission. The Investment Bankers Association sent a letter to the SEC, which stated that matters of regulation "should be aired in the full light of day," as business "depend[ed] for its vitality on the flexibility which comes from the diversified efforts, independent judgments and vibrant energies of independent business men."<sup>147</sup> As business came to accept the importance of government regulation, members of the SEC began to understand the importance of business and finance. Paul Gourrich and David Schenker, Chief Council of the Investment Trust study started the investigation "with a punitive attitude toward the investment company industry," yet overtime, "became more open-minded, realizing there were good companies as well as bad."<sup>148</sup> Given this new understanding, fund leaders and SEC commissioners could come together during hearings to shape a mutually beneficial act.

Robert E. Healy, the supervisor of the investment company report, presented the opening statement at the Senate hearing, where he introduced the themes that Frank instilled as central to the SEC's mandate. Healy highlighted flexibility as a fundamental necessity of the administrative process. He noted that while a lack of discretionary power would indeed make the administrative job easier, this would not ensure that the Act would achieve its goals in the long-term. He explained that "rigid rules" prevented the Committee from solving difficult problems and predicted that both industry and government representatives would "find that it is necessary

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<sup>147</sup> "Summary of IBA Letter to SEC," *Wall Street Journal*, March 19, 1940.

<sup>148</sup> Paul Cabot quoted in Groh, "Boston-Type Open-End Fund," 474. Quote found in interview with Paul C. Cabot by Ralph J. Tosiello, October 22, 1971. Paul Cabot was the Board Chairman of State Street Investment Company, and recalled details about the hearings in this interview.

to put a little rubber into the Bill, for the exceptional, unforeseeable and unpredictable cases.”<sup>149</sup> Healy noted that others regarded the bill as “mild” and “a well-considered measure.”<sup>150</sup> Healy’s use of “mild” did not mean that the SEC ceded too much to finance, but that enough flexibility was left within the bill so that it could be re-written with the incorporation of new ideas and new findings. Here is where Frank’s more radical ideas emerged – the SEC wanted to leave space in the bill to be able to respond to changing circumstances and adjust policy accordingly.

Healy then highlighted what the bill did not attempt to do – namely prescribe the “ideal” form of investment vehicle for the entire industry to conform to.<sup>151</sup> Instead of limiting the “existing diversity” of investment companies, the SEC wanted to let diversity flourish by having these companies explicitly label themselves to better inform investors about their strategies.<sup>152</sup> This too was consistent with Frank’s rejection of absolutism. Frank would not limit the range of investment vehicles, as he knew that facts and circumstances would constantly change and necessitate a diversity of options.

Healy concluded with the overall purpose of the Act, which was to increase protection for the small investor and fund industry when it needed it the most. The shadow of war could not be ignored and it provided an urgency to realize these aims. Healy declared that the Act would inspire confidence in investors and thus stimulate recovery and bring more capital to vital industries.<sup>153</sup> In its “declaration of policy,” the bill set out that all the abuses in investment companies adversely affected “national interest and the interest of investors,” which again

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<sup>149</sup> *Investment Company Act Hearings*, 12.

<sup>150</sup> *Investment Company Act Hearings*, 10.

<sup>151</sup> *Investment Company Act Hearings*, 10.

<sup>152</sup> *Investment Company Act Hearings*, 10.

<sup>153</sup> *Investment Company Act Hearings*, 13-14.

illuminated how specific matters of finance were placed in the larger frame of the nation's security.<sup>154</sup>

On April 26, Arthur H. Bunker, Executive Vice President of The Lehman Corporation in New York, introduced a thirty-three point outline of changes the fund industry wished to see made to the bill.<sup>155</sup> Senator Taft told Paul Cabot, "You ought to have your head examined. If you think you can sit down with those Democratic bastards and get anywhere, well your [sic] nuts."<sup>156</sup> The SEC, senators, and fund companies all had work together to negotiate the future of the bill. The SEC did have to surrender some of its initial requests to pass the legislation. Yet, this cooperative effort did not mean that the SEC abandoned its overall push for reform and ceded all power to fund companies. The most radical provisions the SEC proposed – eliminating leverage and giving the Commission jurisdiction over the size of investment companies – remained intact. These were the two areas that Frank had the strongest views on and that fit coherently within the philosophical framework he was building.<sup>157</sup>

Among one of its most drastic suggestions, the SEC wanted to prevent open-end funds from using leverage to finance their investments as written in Section 12 of the bill. Over-leveraged companies were the vehicles that played a significant role in the financial collapse, yet with the 1929 crash over a decade past, demanding that companies cease borrowing was controversial and contested. Paul Cabot delivered the strongest opposition to the leverage limitations and drew upon the American tradition of relying on credit to finance expansion, to strengthen his case. First, Cabot deemed the limits on senior capital to be "arbitrary" and challenged the idea that

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<sup>154</sup> *Investment Company Act of 1940*, Section 1.

<sup>155</sup> Groh, "Boston-Type Open-End Fund," 516.

<sup>156</sup> Taft quoted in Groh, "Boston-Type Open-End Fund," 516.

<sup>157</sup> *Investment Company Act Hearings*, 1110.

investment companies should be treated differently from individuals who still had the right to borrow.<sup>158</sup> He then built his case by appealing to images of America's pastime:

It must be remembered that the United States was in a large measure built on borrowed money, and had there been in other industries and activities of other times a restriction on borrowing, it would have been impossible to open the West and to develop the great natural resources that have made this country what it is today... At times, a reasonable and legitimate use of credit can be of great benefit to the borrower, to the lender, and to the public at large, through the results of greater employment and industrial activity.<sup>159</sup>

While Cabot looked to the long gone past, Frank and others at the SEC remembered the damage leverage wreaked on the system just a decade ago. Frank delegitimized those old investment trusts, which he argued were not true investment vehicles, as they only “[played] the market.”<sup>160</sup>

Leverage in no way could achieve the type of economic citizenship Frank wanted. Since leverage encouraged investors to speculate in the market in the hopes of getting rich quick, this not only exposed individual investors to excessive downside risk, it also failed to align the individual and business together for the long-term. The SEC ultimately won the battle on leverage. Open-end funds, the prominent investment vehicles at the time were restricted from using leverage. The Investment Company Act did not provide any leeway, stating, “It shall be unlawful for any registered investment company... to purchase any security on margin.”<sup>161</sup>

Controversial provisions in Section 14(a) provided the basis for the next battle. This section called for a cap to limit the size of investment companies, potentially curbing private enterprise's ability to engage in business. On April 9, the Commission, the Senate and fund representatives

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<sup>158</sup> *Investment Company Act Hearings*, 482.

<sup>159</sup> *Investment Company Act Hearings*, 482.

<sup>160</sup> Letter, Jerome Frank to Paul P. Gourrich, May 12, 1938; Group 222, Series III, Box 27, Folder 255; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

<sup>161</sup> *Investment Company Act of 1940*, Section 12. The only security that could be purchased on margin was short-term credit only as needed for the clearance of transactions. This section of the act also prohibited short-selling of securities “except in connection with an underwriting in which such registered company is a participant.” The act also regulated the capital structure of closed-end funds: it declared unlawful that any closed-end fund issue or sell senior securities unless it represents an indebtedness “immediately after such issuance or sale, it will have an asset coverage of at least 300 per centum” or that “provision is made to prohibit the declaration of any dividend... Unless, in every such case, such class of senior securities has at the time of the declaration of any such dividend or distribution... of at least 300 per centum.” *Investment Company Act of 1940*, Section 12.

discussed the SEC's suggestion to limit the size of investment companies to \$150 million. Chief Counsel Schenker tried to justify the cap: he explained that a cap could limit the losses if the market took a turn for the worse.<sup>162</sup> Schenker then took time to explain that the cap did not restrict any specific kind of investment, it just limited the size of investments to protect the public interest and the individual investor.<sup>163</sup> Senator Townsend questioned Mr. Schenker about the decision to limit the investment companies somewhat arbitrarily at \$150 million. Schenker cited the almost "unanimous consensus of opinion" from managers and the history of the largest funds taking "the worst lickings" as reasons to limit size.<sup>164</sup>

On April 16, fund leaders had a chance to contest the cap. Paul Cabot outlined his critique to the overall proposed bill, and one of his nine objections related to Section 14(A). He rebutted by deeming forceful federal regulation of size as unwise, and arbitrary limitations as unsound. He looked to past precedent to build his case:

If in the past there had been rigid limitations as to the size of other industries – although it is true that some difficulty and grief might have been avoided – it is equally true that the great growth of this country could never have taken place. For example, if years ago the automobile industry had been told that it could never expand beyond a definite size, it is probable that great business could never have grown to its present importance.<sup>165</sup>

Cabot concluded by arguing that competition between companies would ultimately lead funds to their ideal size, rather than government regulation. Merrill Griswold, Chairman of Massachusetts Investment Trust, had even stronger words about this provision. He spoke:

This arbitrary limitation is one of the most revolutionary provisions of this bill. It is utterly without precedent. No other type of business has ever been subjected to such limitation. . . . And most important of all, general investor interest in our shares will be greatly lessened, merely because the imposition of an arbitrary size limitation will cause many investors to fell

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<sup>162</sup> Schenker made an analogy to a run on a bank: if everyone tried to liquidate their shares at the same time in a huge fund, the market as a whole would suffer and could leave investors without liquidity. *Investment Company Act Hearings*, 247.

<sup>163</sup> *Investment Company Act Hearings*, 247.

<sup>164</sup> *Investment Company Act Hearings*, 248.

<sup>165</sup> *Investment Company Act Hearings*, 484.

that the Government believes large trusts to be unwieldy and inefficient. This same fear of Government disapproval may cause many shareholders to liquidate their interest.<sup>166</sup>

Here we see that Cabot and Griswold tried to seize upon the fears of the time to make their case. They argued that a government imposed limitation on size was both unprecedented and would cripple growth in industries when growth was among the most imperative aims. While the emergency mobilization before WWI completely unshackled business, Frank would not let the new emergency hinder his long-term plan to implement oversight of business that would ultimately unleash the power of industry.

Frank spoke at the Kiwanis Club of Cleveland on April 25, and placed the discourse on the matter of size in a larger political and philosophical context. His philosophy found a middle ground between the SEC's proposed hard cap and business' desire to have size be determined by the market. Frank emphasized the need to look at industries on a case-by-case basis, rather than demonizing bigness in totality as he believed that in some industries, bigness was "almost indispensable." Frank called it "foolish... to make an antithesis between big business and small business" as each had "its legitimate place in the American scheme of things." Frank cautioned his listeners about falling victim to dogma: neither big business nor little business was the answer or the problem. Frank explained, "Bigness and littleness are relative terms. Life is not static and no size-formula can be static...As to any specific industry, the question is always pertinent: 'What, at this particular moment, is the most desirable size?'"<sup>167</sup> Here, Frank's legal, political, and economic mind was fully at work. He managed to justify the cap through his experimentalist theory, and by doing so proved that administrators would need to actively

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<sup>166</sup> *Investment Company Act Hearings*, 495-97.

<sup>167</sup> Citations in this paragraph are from, Jerome Frank, "Regional Financing," (speech, Ohio, April 25, 1940), Securities and Exchange Commission Library, <https://www.sec.gov/news/speech/1940/042540frank.pdf>.

monitor industries and businesses that were operating in constantly changing and complex environments.

Ultimately, the final version of the '40 Act gave the SEC authority to investigate over-allocated funds that created “any problem involving the protection of investors” or “of the public interest” and present the findings to Congress.<sup>168</sup> Removing a hard cap, yet maintaining the ability to assess size on a case-by-case basis, fit perfectly with Frank’s professed framework. The flexibility and discretion worked into the Investment Company Act allowed Frank to institutionalize his vision of a world where men would be in charge of responding to an ever-changing, complex world instead of a set of rigid laws.

These new regulations represented “an ultimate victory for the open-end funds,” as the provisions accorded with and benefitted the structures the biggest and most successful open-end funds started to employ.<sup>169</sup> While closed-end funds were often highly leveraged with different classes of securities, open-end funds became simpler vehicles that only used common stock. Edward Leffler, the founder of Massachusetts Investors Trust, argued that issuing one class of security, namely common stock, would be more democratic as it would “give all investors an equal chance” and allow investors to liquidate shares at anytime if they disagreed with management.<sup>170</sup> Frank of course also argued for equity financing over debt, and did so even more strongly in the face of war. Frank delivered a speech to the Army Industrial College, titled “In Time of War Prepare for Peace,” where he argued that over bonded companies would not meet the demands of an industrial recession that could emerge as the nation transitioned into

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<sup>168</sup> *Investment Company Act of 1940*, Section 14.

<sup>169</sup> Groh, ““Boston-Type Open-End Fund,”” 507.

<sup>170</sup> Groh, ““Boston-Type Open-End Fund,”” 51.

peacetime.<sup>171</sup> Overall, bonds would not provide companies with the flexibility they needed to respond to changing times, and bonds would not give investors the returns they needed to benefit from American industry. Stocks, on the other hand, allowed industry to evolve and grow, and gave individuals a stake in seeing that to fruition. Hugh Fulton, Assistant US Attorney of the Southern District of New York, hypothesized during the Investment Company Act Hearings that the investment company could become the best way to enable a person with modest means to “bet on the United States.”<sup>172</sup> Indeed, by championing the open-end structure, individual investors would receive more protection, and thus feel emboldened invest in the nation’s financial system for the long-term.

### **World War II Comes Closer to Home**

Frank initially believed that America should remain isolationist, yet when France fell to Germany in spring of 1940, he reversed his stance as the gravity of the situation set in. Frank believed America needed to play an active role in stabilizing the international order and used the crisis abroad to expand the reach of the Investment Company Act and the SEC.

While I have argued that the emergency abroad fast-tracked reform and put it on a long-term footing, this is not the consensus view. Historian Barry Karl argues that fears of fascism led Americans to critique FDR as a dictator, which limited the administration’s ability to plan a government run war machine.<sup>173</sup> Legal scholar Reuel Schiller echoes these sentiments, arguing that “as Americans came face to face with terrifying manifestations of administrative power abroad they began to distrust it.”<sup>174</sup> And finally, political scientist Ira Katznelson too contends that the fear of democratic collapse was a real concern that drove policy – he took a more sinister

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<sup>171</sup> Jerome Frank, “In Time of War Prepare for Peace,” (speech, Washington, D.C., April 8, 1940), Securities and Exchange Commission Library, <https://www.sec.gov/news/speech/1940/040840frank.pdf>.

<sup>172</sup> *Investment Company Act Hearings*, 11.

<sup>173</sup> Karl, *An Uneasy State*, 194.

<sup>174</sup> Reuel Schiller, “Reining in the Administrative State,” 188.

view of this fear, arguing that it led FDR's administration to make compromises that were at times undemocratic.<sup>175</sup> Indeed, the potential for quick and large-scale mobilization did convince some to abandon reform in an effort to get capital flowing into business unrestricted. James Farley, the DNC Chairman, indicated that he was concerned about a bear market preventing the development of a robust defense program. The *Times* reported that Farley believed "it would be patriotic as well as good politics if the SEC could be prevailed upon to relax its regulations against directors of companies in order that they might support the market..."<sup>176</sup> A memo from May 30 indicated that the President received two wires regarding the "necessity of releasing the money jam in the present war crisis."<sup>177</sup>

Amidst some calls for the end of reform, big business did not win the fight over government control and regulation in the effort to mobilize for and fight in WWII. Mark Wilson supports this view in *Destructive Creation: American Business and the Winning of World War II*, where he presents his research in military and business archives that demonstrates how government funds and regulation made business mobilization both possible and successful. He contends that FDR's "arsenal of democracy" relied upon a cooperative partnership between the public and private sector, instead of the complete free reign of business, as many scholars have argued.<sup>178</sup> The story of the Investment Company Act illuminated how war managed to secure a partnership between government and business, which proved to be pivotal as the nation inched closer to war.

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<sup>175</sup> Ira Katznelson, *Fear Itself*. Katznelson cites allowing Southern congressmen to defend their racist polices and cooperating with the Soviets and other dictatorships as examples of this.

<sup>176</sup> Memorandum, James A. Farley to FDR, May 28, 1940; Official File 1060 – Securities and Exchange Commission, Box 3, SEC April – June 1940; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>177</sup> Memorandum, Max Vineberg to FDR, May 29, 30, 1940; Official File 1060 – Securities and Exchange Commission, Box 3, SEC April – June 1940; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>178</sup> Wilson, *Destructive Creation*. Wilson also explains that while the partnership developed between business and government largely relied on cooperation, it at times emboldened the business community to speak out about government as a threatening rival and promote the values of private for-profit firms.

Given that Frank believed a strong economy was a fundamental element of a democracy, the war effort provided an opportunity to shift the SEC's mandate from the protector of the individual investor to the protector of the nation. Starting in 1940, the SEC increasingly influenced the war effort. In May, Senator Josh Lee wrote to FDR to follow-up on their conversation about mobilizing finances to prepare for war. Lee voiced his support for Frank's involvement, writing that Frank "indicated his desire to have some of the boys in his Department do a bit of pick and shovel work on such a plan" and asked for the President's approval."<sup>179</sup> A subsequent memo stated that General Watson and Frank were working together on war financing.<sup>180</sup>

Frank used this emergency to further reinforce his long-term plan as demonstrated in a letter he wrote to FDR titled "Using Equity to Finance Defense Plants." Frank suggested that FDR use equity financing for defense plant expansion rather than loans. Frank crafted a plan where government did not directly control business, but instituted a framework for equity financing which he believed was safer for investors and the economy in the long-run. Frank wrote that either government would finance plants by purchasing non-voting stocks as to limit its own involvement in business, or that stocks would be purchased by investment companies and be sold to citizens who would have voting power.<sup>181</sup> The plan Frank delineated avoided direct government control of business; instead, it created a private means of funding business – investment companies – that carried out investments in the best way government saw fit.

The administration continued to see economic security as a precursor to national security as war approached. Frank expanded on this philosophy in an article entitled "Government

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<sup>179</sup> Letter, Josh Lee to FDR, May 10, 1940; Official File 1060 – Securities and Exchange Commission, Box 9, Miscellaneous 1934-1944; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>180</sup> Memorandum, Jerome Frank to FDR, May 13, 1940; Official File 1060 – Securities and Exchange Commission, Box 3, SEC April – June 1940; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>181</sup> Citations in this paragraph are from, Confidential Memorandum, Jerome Frank to FDR, May 18, 1940; Series III, Box 37, Folder 606; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

Financing of War,” where he explained that whatever the scope of the war, the ultimate purpose would be to preserve capitalism in America’s democracy. Thus, war plans themselves had to be devised “to continue, as far as possible, even in war time, on a free enterprise or capitalistic basis.”<sup>182</sup> Frank wrote a letter to FDR illuminating the connection between war preparation and the economy: “In the light of the fact that Hitler’s conception of a total war involves attacks on economic weaknesses as an important weapon, it would seem that without much delay we should move to plug several holes.”<sup>183</sup> The larger “we” Frank spoke of was not just government, but involved active engagement and input from finance. On June 14, Frank wrote FDR a letter noting that Frank Bonner, President of the National Association of Security Dealers, called him to offer support from investment bankers in financing the war.<sup>184</sup> Frank assured Bonner that the administration would “‘do everything in its power’ to help private capital finance plant expansion for national defense.”<sup>185</sup> Frank again stressed the importance of a joint effort and the necessity for government to facilitate financing channels. In this vein, he advocated for the use of “normal financial channels” except for when the “exigencies of national defense” called for the use of other methods, which Frank believed should be kept at a “minimum.”<sup>186</sup> Overall, Frank concluded that the mechanisms to finance the war should first and foremost “perform the job with the least disturbance to the ordinary financial life of the community compatible with the supreme aim of winning the war” and secondly, “to perform the job with a minimum of

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<sup>182</sup> Jerome Frank, “Government Financing of War: The Demands on Private Income and Consumption,” *Trust and Estates*, August 1940.

<sup>183</sup> Memorandum, Jerome Frank to FDR, June 7, 1940; Official File 1060 – Securities and Exchange Commission, Box 3, SEC April – June 1940; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>184</sup> Confidential Memorandum, Jerome Frank to FDR, June 14, 1940; Series III, Box 37, Folder 606; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

<sup>185</sup> Confidential Memorandum, Jerome Frank to FDR, June 14, 1940; Series III, Box 37, Folder 606; Jerome New Frank Papers (MS 222). Manuscripts and Archives, Yale.

<sup>186</sup> E.S. Duffield, “Defense Financing: US to Aid Private Capital in Raising Funds for Plants,” *The New York Times*, June 21, 1940.

undesirable after-effects.”<sup>187</sup> The insistence on business as usual was not in the same laissez-faire spirit as it was during WWI; instead, it was to ensure that the way government and business exercised power was not in a totalitarian manner to deal with a shortsighted war emergency. When Laughlin Currie wrote to the administration asking to collaborate on finance plan for war that involved the Treasury, the SEC, and the Federal Reserve, Frank declared he would not support a wartime authorization of forced loans, and for the time being, FDR followed suit.<sup>188</sup> Even as war came closer, Frank did not want to use financial structures that would help the nation mobilize in the short-term but would leave the nation unable to transition to a strong post-war economy.

In the end, the industry and the SEC worked together to expedite the bill, with the *Times* reporting that both sides “expressed the opinion that regulation would benefit the industry and enable it to play a large part in providing new capital for financing vital defense industries.”<sup>189</sup> The Investment Company Act passed at the end of August with unanimous support from both houses of Congress. FDR delivered remarks on August 23:

As the pressure of international affairs increases, we are ready for the emergency because of our vigorous fight to put our domestic affairs on a true democratic basis. We are cleaning house, putting our financial machinery in good order. This program is essential, not only because it results in necessary reforms, but for the much more important reason that it will enable us to absorb the shock of any crisis.<sup>190</sup>

In his speech, FDR continued to conflate the home front and the battlefield to galvanize support for greater reform. FDR then outlined the functions that he wanted the regulated investment

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<sup>187</sup> Citations in the paragraph are from, Jerome Frank, “Government Financing of War: The Demands on Private Income and Consumption,” *Trust and Estates*, August 1940.

<sup>188</sup> Memorandum, Laughlin Currie to FDR, June 4, 1940; Official File 1060 – Securities and Exchange Commission, Box 3, SEC April – June 1940; Franklin D. Roosevelt Library, Hyde Park, New York; “Forced Loans for War Financing: Roosevelt Won’t Ask Action This Session But Lee Bill May Win Support if Changed,” *Wall Street Journal*, June 7, 1940.

<sup>189</sup> “Compromise Made by SEC and Trusts: Agreement on Regulatory Bill Clears Way for Possible Action by Congress,” *The New York Times*, May 31, 1940.

<sup>190</sup> Franklin D. Roosevelt, “Statement on Signing Two Statutes to Protect Investors,” (August 23, 1940), The American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=15993>. Frank drafted remarks for FDR.

companies to serve: "I have great hopes that the act which I have signed today will enable the investment trust industry to fulfill its basic purpose as a vehicle to diversify the small investors' risk and to provide a valuable source of equity capital for deserving small and new business enterprises which the investment bankers have been unable to finance."<sup>191</sup> At a press conference, FDR reiterated that the Act was "an aid to small business; honest business, and part of the regular Administration program in social legislation that was very much needed."<sup>192</sup> The purpose of this bill was not just to alter financial machinery, but also to play a role in changing the social fabric of the nation. Securing funding for small business and protection for the individual investor fulfilled the vision of Senator Wagner, the champion of the bill who believed that "in order that the strong many not take advantage of the weak, every group must be equally strong."<sup>193</sup>

Senator Taft, a strong opponent of the bill and of regulation in general, understood how significant and impactful the impending regulation was, and predicted on the Senate floor that, "In the end [the fund companies] will bitterly regret that they have agreed to that kind of regulation."<sup>194</sup> However, given that the government and private industry had similar interests at this time – freeing up capital, ensuring the nation was prepared for war, protecting small investors and small business, and inspiring confidence in investors – the regulation proved beneficial for all parties involved. After final negotiations between the government and the fund companies, each side expressed great satisfaction with the outcome of the bill. Paul Cabot called

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<sup>191</sup> Franklin D. Roosevelt, "Statement on Signing Two Statutes to Protect Investors," (August 23, 1940), The American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=15993>. Frank drafted remarks for FDR.

<sup>192</sup> Franklin D. Roosevelt, "Press Conference," (Washington, D.C., August 23, 1940), The American Presidency Project, <http://www.presidency.ucsb.edu/ws/index.php?pid=15994>.

<sup>193</sup> Senator Wagner testimony to the Senate Committee on Education and Labor in 1935.

<sup>194</sup> Taft quoted in Groh, "Boston-Type Open-End Fund," 539.

the bill “excellent,” Merrill Griswold said the bill had “practically unanimous approval of the open-end companies,” and Senator Wagner called the legislation “reasonable” and “sound.”<sup>195</sup> The ‘40 Act managed to expand the power of the entire economy and reject the notion of a zero-sum game: the Act would give power and protection to small business and investors without diminishing the strength of larger players, which led all parties to express satisfaction with the bill.

Right before the Investment Company Act came into effect on November 1, Frank delivered a speech titled “The Sin of Perfectionism” which responded to and justified the SEC’s increased administrative discretion. In his remarks, Frank categorized blind adherence to set beliefs and procedures as ineffective and absolutist, pointing out that dictatorships instill the “dogma that those who hold office can never err.”<sup>196</sup> He explained that the SEC, on the other hand, was fallible and susceptible to mistakes, yet was unwaveringly “devoted to democracy.”<sup>197</sup> By recognizing the SEC’s fallibility, Frank did not render the agency ineffective, but elevated it as an even more critical component in the democratic process. He argued that accepting “unavoidable imperfection improve[d] effectiveness,” as it prevented decision makers from stretching goals and beliefs “beyond their practically possible scope” and oriented them more towards fact-finding.<sup>198</sup> By understanding that the regulations the SEC proposed were neither fixed nor perfect, Frank created a space for commissioners to continually find ways to improve the regulation and the systems they acted on. Malleability, deliberation, and fact-finding became essential elements in the process to continually improve social structures in complex times.

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<sup>195</sup> Cabot, Griswold, and Wagner quoted in Groh, “Boston-Type Open-End Fund,” 518.

<sup>196</sup> Frank, “The Sin of Perfectionism,” 21.

<sup>197</sup> Frank, “The Sin of Perfectionism,” 24.

<sup>198</sup> Frank, “The Sin of Perfectionism,” 21.

Frank transitioned from discussing broad administrative flexibility to discussing the specifics of the Investment Company Act. He addressed criticism waged by E.F. Connelly, President of the Investment Bankers Association, that government overregulated securities transactions and that this type of regulation “paralyze[d] free private enterprise and promote[d] totalitarianism.”<sup>199</sup> Frank referenced Connelly’s colleagues who called for Congress to pass the Investment Company Act, with the understanding that regulation would in fact lead to a more democratic society. He said that these bankers, “knew that the pre-regulation exploitation of thousands of middle-class investors might constitute a prelude to totalitarianism” and prolonged exploitation would lead the middle-class to turn to a dictator, “who, falsely promising to save the middle class, would destroy it, and, with it, democracy and capitalism.”<sup>200</sup> To prevent any further exploitation of the middle-class, and to ensure that the middle-class could reap the full rewards of the market, Frank installed the Commission as a continual actor in the regulatory process. Frank understood the economy and democracy as “intertwined” and believed if either came under pressure of collapse, democracy would “give way to dictatorship.”<sup>201</sup> Thus, proliferating regulation to constrain businesses was not the goal. He explained: “We do not want excessive governmental regulation. We want only so much of it as is essential to make our kind of economy function competently so that this country may enjoy the prosperity for all its people.”<sup>202</sup> The increasingly active SEC – conducting studies, gathering information from financiers, and maintaining a strict adherence to objective fact-finding – became a powerful administrative body in seeing this goal to fruition.

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<sup>199</sup> Frank, “The Sin of Perfectionism,” 25.

<sup>200</sup> Frank, “The Sin of Perfectionism,” 25.

<sup>201</sup> Frank, *If Men Were Angels*, 165.

<sup>202</sup> Jerome Frank, *If Men Were Angels*, 165.

## Conclusion

When all was said and done, the SEC remarked: “The Investment Company Act represents the minimum workable regulation of investment companies.”<sup>203</sup> Historians use this quote as definitive evidence that the SEC felt and recognized its own defeat, ceding almost all of its power to the fund companies.<sup>204</sup> As a preliminary counter to this assessment, it is evident that the Act helped *both* the SEC and fund companies achieve immediate goals. The new investment funds became specialized to finance war industries and helped the nation achieve production goals by channeling in private capital.<sup>205</sup> In peacetime, these funds continued to attract capital, with total assets in the mutual fund industry climbing from \$450 million in 1940 to \$2.53 billion by 1950.<sup>206</sup> The open-end fund became the most ubiquitous investment vehicle for Americans, which satisfied the government’s goal of encouraging citizens to finance industry with equity purchases, and satisfied the industry’s goal of being the intermediary facilitate the flow of this capital. Yet given that this thesis understands the transformation of the relationship between government, citizens, and the market as the New Deal’s most important legacy, assessing the Investment Company Act by looking at what specific legislative details or goals did or did not come to fruition misses the entire point.

The true legacy of the Investment Company Act rests with the larger philosophical shift that Jerome Frank embedded within the regulation. By institutionalizing the SEC as an actor in, rather than overseer of the market, laissez-faire capitalism was no longer championed as the most efficient way to allocate capital and achieve growth; instead, Americans came to understand that

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<sup>203</sup> SEC representative quoted in Groh, ““Boston-Type Open-End Fund,”” 540.

<sup>204</sup> Groh, ““Boston-Type Open-End Fund,”” 540; Seligman also points to this quote to argue his point that this bill was a failure on the part of the SEC.

<sup>205</sup> Groh, ““Boston-Type Open-End Fund,”” 415-17.

<sup>206</sup> Investment Company Institute 2016 Investment Company Fact Book, 72 fig.1, *available at* 172, [https://www.ici.org/pdf/2016\\_factbook.pdf](https://www.ici.org/pdf/2016_factbook.pdf). New sales were \$290 million just by 1945.

markets required active participation by a regulatory body that would help business, finance, and investors adjust to macro conditions and thus help realize their full potential in all circumstances.

Frank ushered in federal securities regulation that gave the SEC regulatory power far exceeding the early New Deal legislation. When the bill was introduced for the first time, Wagner explained that the greater purpose of the Act was “not merely to insure to investors a full and fair disclosure,” and Healy added that it reached “considerably beyond” the disclosure requirements of the 1933 and 1934 Acts.<sup>207</sup> When the Act passed, the SEC gained the jurisdiction to outlaw margin trading, prevent short selling, limit underwriting, curb borrowing, eliminate conflicts of interests with boards of directors, prohibit pyramiding, restrict the sources of dividend payments, and prescribe uniform accounting and reporting methods.<sup>208</sup> While these regulations were the most comprehensive in history, the discretionary power awarded to the SEC represented the most unique and radical outcome of the Act. In remarks Frank drafted for FDR, he wrote: “the history of the Investment Trust Bill sheds light, most interestingly, on the emptiness of a slogan glibly voiced by certain politicians who purport to decry administrative discretion as harmful to business and inimical to democracy.”<sup>209</sup> While fund managers initially decried the SEC’s proposed discretionary powers, the investment trust industry ultimately “confer[red] upon the SEC far more discretionary power” than the SEC even originally sought.<sup>210</sup> When FDR signed the Act, he attributed this increase in discretionary power to the SEC’s ability to handle financial problems in a fair, objective manner. More importantly, he said it revealed the new attitude of businessmen who now realized that “efficient regulation” required

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<sup>207</sup> Wagner quoted in Groh, ““Boston-Type Open-End Fund,”” 508; “Healy Discusses Investing Trusts,” *The New York Times*, February 29, 1940.

<sup>208</sup> “Summary of the Wagner Trust Bill,” *The New York Times*, March 15, 1940.

<sup>209</sup> Draft of Speech, Jerome Frank to FDR, August 1940; Official File 4089 – Investment Company Act and Investment Advisers Act; Franklin D. Roosevelt Library, Hyde Park, New York.

<sup>210</sup> Draft of Speech, Jerome Frank to FDR, August 1940; Official File 4089 – Investment Company Act and Investment Advisers Act; Franklin D. Roosevelt Library, Hyde Park, New York.

an “administering agency, which has been given flexible powers to meet whatever problems may arise.”<sup>211</sup>

Given that possible involvement in war and the spread of totalitarianism shaped the fears of Americans during this time, Frank had to convey how his radical and controversial ideas were actually a powerful boon to democracy. Through his writing and speeches, Frank persuaded Americans that increased government discretion was a path to a stronger democracy and that increased regulations formed the foundations of a prosperous economy. The Investment Company Act institutionalized this framework as a means to save democracy from totalitarianism, which ultimately proved the validity of Frank’s philosophy and allowed it to take a more permanent hold in American life. The fund industry itself came to appreciate the importance of the SEC’s involvement in shaping regulation and supported the creation of its new investment company division to carry out the duties of the ‘40 Act. After attending a conference with the SEC to navigate the implementation of new regulations, William Tudor Gardiner, the president of Incorporated Investors, remarked: “In these more complicated days the enactment of a law by Congress is only a starting point: rules, regulation and administration are at least as important.”<sup>212</sup> Fund leaders fully embraced a world where an active administrative agency replaced static, absolute laws as the essential element to secure the prosperity of the market.

During the 1940s, Karl Polanyi wrote: “It had been the New Deal, that extended the hope that liberty and security might be reconciled effectively.”<sup>213</sup> Through investment company regulation, Frank demonstrated how administrative engagement and regulation would secure the liberties of

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<sup>211</sup> “Roosevelt Signs Trust Measure,” *The New York Times*, August 24, 1940.

<sup>212</sup> “Schenker Honored by Investor Aides,” *The New York Times*, July 3, 1941.

<sup>213</sup> Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Massachusetts, Beacon Press, 1944), 23.

all Americans by helping the market realize its full potential.<sup>214</sup> The “chaotic world” that threatened not only to spell the end of reform, but also to uproot the nation’s democratic foundation, actually provided the backdrop for Frank to usher in the Investment Company Act of 1940 as a means to save democracy.<sup>215</sup> While Mussolini predicted that the liberal state was “destined to perish,” Frank ensured American democracy would survive in both war and in peace by seeing his comprehensive reform to completion.<sup>216</sup>

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<sup>214</sup> Louis Brandeis, “What Publicity Can Do,” *Harper’s Weekly*, December 20, 1913.

<sup>215</sup> *Investment Company Act Hearings*, 1130.

<sup>216</sup> Benito Mussolini quoted in Ira Katznelson, *Fear Itself*.

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