The story is usually told like this: Bernard Cornfeld, an idealistic young socialist, is the son of a widowed immigrant in New York. His income as a social worker is slender, and in order to have enough money to take good care of his parents, he begins selling mutual-fund shares in his spare time. Now, the young socialist experimenter a conversion; he perceives that the open-end investment fund can be made to resolve the cruel contradictions of capitalism. What if the only rich who can invest in the wealth created by capitalism and thus increase their wealth is because the poor have few dollars left over from purchasing the necessities of life. They cannot afford to tap into their slender surplus in investments. To sell shares successfully, you need expert brokers. But now the mutual-fund salesman goes among the people. Through him, they are enabled to turn their savings into shares in a Fund. Many millions are thus assimilated into a great whole. Wise men invest this ample Fund in the shares of many industrial concerns. And if, as should normally be the case, most of these investments rise in value, then the rise increases the value of each of the shares of the Fund. Thus the savings of the poor are Multiplied, without risk. And the Fund itself makes sure that it will always remain a purchaser’s advocacy, immediately, for cash. The advantages of investment are combined with the blessings of its great opposite, liquidity. In the legend, at least, Bernard Cornfeld accepted with religious fervor the excellence of this vision. He has himself recalled the birth of a conviction that “money possesses a strange kind of purity” and the further conviction that capitalism could now be employed to bring about the kind of beneficence to which he was inclined. This idealized portrait of the open-end fund mechanism is not totally at odds with reality. But there are some important variations possible, such as the size of the cut that the salesman takes for himself, and the manner of insuring that the little people’s savings are deployed with suitable wisdom.

Cornfeld started at Brooklyn College under a considerable disadvantage. He had a salesman who was bad enough for him to ask teachers not to put questions to him in public. This speech impediment, and the successful treatment which he received for it, may well have affected the whole course of Cornfeld’s life. By the time he came back from the sea in 1947, his stammer was proving enough of a liability to make him seek treatment. He consulted a lay therapist, named Willard Brencher, and told him that he wanted to cure his stammer in order to become a salesman like his elder half-brother, Eugene. At a practical level, Brencher told Cornfeld that he must cease asking his teachers to exempt him from questions. On the contrary, he must seek out every opportunity for public speech and performance. Cornfeld acted upon this advice, and, within a very few months, his stammer came and went as if by magic, and virtually disappeared. The experience was the starting point in Cornfeld’s love affair with applied psychology. Human motivation, for Adler, was a process of “goal-seeking” and the most important goal for which people strive is “superiority.” Adler does not mean that people have a tendency to be essentially superior -- indeed, he considers the capacities and skills that people have, in order to be essential human accomplishments -- but more frequently it seems to be little more than wealth, success, or dominion. Adlerians believe that people who have suffered from “organic inferiority,” such as stammering, can use up “victims’ compensations” by striving especially hard to achieve superiority. In the Adlerian world, you might expect an “ex-stammerer to become a great orator."

But it is all there; the ambiguous role of money in the market, the opacity of Wall Street and the banks, the contingencies between the financial establishment and mainstream economists, the techniques of master financiers and the psychology of their naïve victims, the reputation as a purchasable commodity, the self breeding power of money, the capitalistic debtor-creditor engine, the overpowering nature of money, the capitalistic debtor-creditor engine, the overpowering motivation of profit, the pervasive role of deceptive salesmanship and many other factors that pollute the integrity of theoretical thinking. But this is not a book against capitalism, or its supposed essence of finance – the characterizing element of the capitalistic system – against which any economic theory should be measured.

BACKGROUND OF BERNARD CORNFELD

It was Bernard Cornfeld’s declared ambition to make Investments Overseas Services the most important economic force in the Free World. The game was mutual funds. Thousands of salesmen, calling themselves “financial counselors,” combed the earth for people’s savings, and put them into the funds which IOS managed, creaming off enough in the process to make the most successful of them very wealthy. Mutual funds in themselves are an old and well-tried form of investment. A special variant was that IOS was the biggest and best-known of the “offshores” funds. That meant that these funds, and the companies that managed them, were carefully registered and domiciled wherever in the world they would most avoid taxation and regulation. There was nothing new about that either.

I(O)S tendencies to be creating wealth for the many when it was really making money for the few"

What was phenomenal about IOS was its success. On the foundation of its offshore mutual funds it built up a complex of banks, insurance companies, real-estate promotions, and every other kind of financial institution you can think of. “Total Financial Service” was the slogan. By the end of the 1960s, IOS had a shade under two and a half billion dollars of other people’s money to manage, and Cornfeld was publicly acknowledging that IOS was the world’s biggest swindler. By the end of the 1960s, IOS had also made a fortune valued at over $1 billion for Cornfeld personally. It had made around a hundred of its associates millionaires as well. Cornfeld was the most talked about financier in Europe since the Great Depression, and IOS was insistently and on the whole successfully – asserting the right to sit at the golden table of the world’s most respectable financial institutions. The only trouble was that IOS was not a respectable financial institution. It was an international swindle.

IOS was the creation of Bernard Cornfeld and Edward M. Cowett. Together these two men built up an organization so steeled in financial and intellectual dishonesty and directed so recklessly that it was absurd when their activities were seen to be entangled with such a wealth of people’s money, let alone praised for the brilliance with which it was managed. We have talked to many of the people who work for IOS, and there were a lot of decent, even idealistic, people among them. Few were aware of the essential dishonesty of the thing they worked for. Most people have a good deal of difficulty in accepting the idea that a large and well-publicized international business could have been run in such a manner: “It can’t be true,” is the natural reaction, “because it was true, how did they get away with it?” There are many answers to that question.

Below are just some of the kinds of misbehavior that IOS committed under Cornfeld and Cowett:

1. Money which they said was held on trust for the customers was used to finance maneuvers for the benefit of IOS itself, its directors and employees, and their friends.
2. At many times, and in many parts of the world, the IOS sales force engaged in illegal currency transactions on a massive scale. Attempts have
In the first week of February 1970, Cornfeld flew to New York to be the principal speaker at a conference organized by a periodical called the Institutional Investor. The invitation was a remarkable enough accolade in itself: the use Cornfeld chose to put it to was a breach-taking illustration of his nerve. It is important to understand the setting, the occasion, and the time.

The setting was New York, the true test and only stage for success in Bernard Cornfeld’s world. He had first come to the city as a child from Turkey in 1939. He was nearly thirty when he left his fortune in Europe. It had been one of the proudest moments of his life when he came back to New York in 1960, as a rich man, and the New York papers interviewed him as the latest verification of the American dream. Making it in New York, he told the reporters then, was what counted. But in 1967 he had been banished from New York. Or rather, while he himself could go there as often as he liked and could cut a flamboyant figure in the East Side discotheques, his firm was banned from doing business there by order of the Securities and Exchange Commission, because of certain irregularities and deceptions. Now he was back in New York again, and with the financial community literally at his feet.

The Institutional Investor is a plump journal, whose elegant pages are not available to the general public. You may subscribe to it if you belong to a firm that is a member of the New York Stock Exchange or if you are otherwise engaged full time in the investment business. It was a gathering of men, and some women, who were collectively responsible for managing tens of billions of dollars of other people’s money entrusted to the ‘insurance companies, pension funds, and mutual funds which they advised on investment. For most of the time, it did nothing of the kind. The customers’ money, in the funds, was frequently invested in unaffiliated business there by order of the Securities and Exchange Commission, because of certain irregularities and deceptions. Now he was back in New York again, and with the financial community literally at his feet.

The night before his speech, he attended the annual cocktail party which the SEC had thrown about his early days, a little shocked by some of the things the SEC had found out about him. Others were amused by his personal flamboyance – the tufty beard and little shocked by some of the things the SEC had found out about him. Others were amused by his personal flamboyance – the tufty beard and nippy-waist tailored suit. But after all, they liked to think of themselves as a bit piratical too.

Cornfeld, would impoverish Wall Street. It is important to understand the setting, the occasion, and the time.

Insofar as he chose to support this sweeping allegation with specific charges, he raised the SEC staff of missing its power – by blocking the prospectus of any firm that continued to do business with IOS. He attacked the Commission for not regulating the trade in unregistered securities, and for impoverishing brokers by suggesting that commissions might be cut for the benefit of the customers. And he deplored its attitude to the enormous flood of brokerage commissions generated by the market. The SEC wanted these diverted back to the customers: that, said Cornfeld, would impoverish Wall Street.

As it turned out, that was almost the last moment when it would have been shown or even sensible to have said any such thing. And nobody would have been saying it, if they had realized the extent of the financial shambles the statesman of People’s Capitalism had left behind him in Geneva.

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had all been spent. At the very moment when Cornfeld, parading himself to the world as a major prophet, was achieving his greatest public acceptance, the train of events was under way which was to expose the absurdity of his pretensions. Less than a year later, he was back in Aix-les-Bains. His shares in IOS had been sold, and he had his last links with the business he had created. Hardly anyone was prepared to hear his views on the future of society any more.

Within weeks of Cornfeld’s trade against the SEC, the stock market cracked and fell even more steeply.

It is time to take a detailed look at what did go wrong. When we have done so, it will become plain that the really interesting question is not so much why Cornfeld and his friends failed. It is how they managed to succeed as long as they did.

For this is not only a story about Bernard Cornfeld and Edward Cowett. They could never have flourished as they did without the acquaintance and, sometimes, the active help of others. Victory, they say, has many fathers, but defeat is always an orphan. It was the same at IOS. After the crash, it was surprising how many people gave us the same excuse: “We never knew!” It is hard to believe that they could not have found out if they had wanted to. This is a story largely populated by people who didn’t want to know, and grew rich in ignorance.

Not all of them were inside IOS. Outside the company and its associates, there were concentric rings of others, less responsible for what happened, who never knew!” It is hard to believe that they could not have found out if they wanted to. This is a story largely populated by people who didn’t want to know, and grew rich in ignorance.

“Physically, he was completely unprepossessing.”

Physically, he was completely unprepossessing, one salesman remembers. “His clothes were baggy — there was never a suit off the rack which could fit Bernie. But then he started to speak. His voice is very soft and reassuring. His smile is very engaging.

There was nothing elaborate about the operation. The firm’s chief and almost only asset, a Chrysler Imperial convertible, has been firmly established as part of the IOS legend. “It was the headquarters of the firm,” really, says Marx, a salesman. “Each weekend Bernie would load up his car and drive from Geneva to Orleans. Sometimes, we would sleep over Saturday night in the car before starting in again on Sunday.” But by the time Marx joined, the firm was on its way to fame. Bernie’s advertisement in the Paris Herald Tribune, offering “American men and women” over $10,000 a year for “sales ability, a willingness to work hard in a fast-growing industry, and a sense of humor,” was running regularly, and striking a very effective chord in the exile community, which prized itself above all, on its sense of humor.

Especially, he was impressed by Bernie’s account of “dollars-cost averaging.” The use of this piece of arithmetical pat was revealed a great deal about the essential techniques of mutual-fund selling. The standard sales pitch is predicated upon the idea that stock markets everywhere increase in value “regularly, and striking a very effective chord in the exile community, which prized itself above all, on its sense of humor.

By 1966, when he went to work for Bernie Cornfeld, much of his career had slipped past in a pattern of bright hopes and disappointments. Franklin Roosevelt may have had detractors as well as admirers within the United States outside the United States he had, for practical purposes, nothing but unqualified admirers. Even in Communist countries, FDR’s son carried a name taken as a guarantee judgment, probity, and, perhaps most important, generosity. The benefits that Roosevelt brought to IOS could scarcely be measured.

Cornfeld was delighted with his new personal ambassador to the international establishment, and quickly put him to work improving IOS’s external relations, which, now needed improvement at the time, as we have seen. But he also took good care that neither Roosevelt nor anyone else should get any wrong ideas about the true strength of Roosevelt’s position inside IOS.

Soon after he joined, Roosevelt characteristically proposed to give a splendid party to celebrate his new functions. Cornfeld agreed, and put the company’s lakeside villa, Belvédère, at his disposal. Roosevelt went ahead with the arrangements for a banquet in the grandest style. An impressive guest list of UN delegates, ambassadors,
In mid-1968 IOS went shopping for some august names in Britain, and Erich Mende, head of the small Free Democratic Party, governor of California is more imposing. Roosevelt was able to persuade a presidential campaign, carries relatively little weight in Europe. A ruinous decision for the sales operation, is possible, would have had the audacity to make it the most glittering social occasion Geneva had seen for many years, the many that had all been invited to meet Bernie. By eleven-thirty, the chef was threatening to commit harakiri amid the aplomb which James Roosevelt brought to the solemn face of Pasier in Terris II. Four hundred people, many of them of the greatest eminence, were invited to Geneva from seventy countries. They assembled on May 28, 1969, in the Intercontinental Hotel, the setting of the famous sales conference. Much earnest oratory was heard from them over the next three days, and we were told that it would last for two years, but we were selling it early the next year. By January 23, 1970, two years later, James Roosevelt, in his capacity as President of Fonditalia, was able to give the investors a glowing report of his second-year-end letter. Fonditalia was associated with blue-chip banks: the Istituto Bancario San Paolo of Turin, as its Depository for Cash in Italy, and the Banque Rothschild as Custodian and Banker. It now had 30,000 investors, and no less than 85,000 million under management. The net asset value of their fund, over a period of time in which the Dow- Jones industrial average in New York had virtually stood still, had gone up by no less than 21.4 per cent. By June 1970, according to Edward Covert Italy was providing no less than 45 per cent of the IOS cash flow.

To succeed in business in Italy, even more than anywhere else, you must fare bella figura: put on an impressive front. IOS's front in Italy was not different from its Renaissance façade. Felberbaum himself operated a cultural center in Milan known as the Angelicum, which operates on the most lavish scale, with its own orchestra, theater, cinema, and classical recording company.

The Swiss investigations showed that in some cases, at least, the gifts made to the Balzan Foundation were "donations" of a very special kind. The donors were paid back – sometimes in Swiss francs – a substantial proportion of the amount of money they gave to the Foundation in Switzerland. Both in Switzerland and in Italy, the press pointed out that this looked very much like a way of enabling wealthy Italians to get their capital out of the lire into good hard Swiss francs, while at the same time avoiding death duties.

The Finter Bank had been involved in similar service before. As we shall see, it had been implicated in one of the most celebrated of Italian financial scandals before IOS came in contact with it. Between them, the Finter Bank's Chuaban and the IOS managers in Italy had tried to smuggle out millions of dollars' worth of currency by an ingenious method. This was done with the co-operation of one Swiss bank in particular, the Finter Bank, through its branch in Chiasso, which is just across the frontier in Switzerland, less than an hour's drive on the autoroute north from Milan.

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We then visited Dr. Chiomenti in his sumptuous office in the Palazzo Orsini. He explained to us that he had resigned from the Board of IOS Ltd., the main company, “because I didn't know enough of what was going on.” It seemed, however, that he knew less than everything about what was going on. The two Confidential Bankers who had been his personal doctors of the money they gave to the Foundation in Italy. From his position at Bregno, far out from Chiasso, the Pesenti family controls Italcementi, one of the largest industrial corporations in Italy, and Pasquale Chiomenti has become a recognized name in the paper-making, banking, and real estate. Pesenti recently sold the Lancio automobile company to FIAT.

How big was Harvey Felberbaum’s black operation in Italy? One estimate put the amount of money he made to be over a million a month in illegal sales, of which half was in cash. He added that this made IOS the biggest single illegal exporter of currency out of Italy.