JPMORGAN'S FALL

How the Wave of Consolidation

NICHOLAS P. SARGEN

Changed America's Premier Bank

AND REVIVAL

JPMorgan’s Fall and Revival

Nicholas P. Sargen

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How the Wave of Consolidation Changed America's Premier Bank

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Preface

This book is the untold story of how an iconic firm, JPMorgan, battled market forces to preserve its heritage, lost when it was acquired by a rival and then re-emerged as a financial powerhouse. It picks up where Ron Chernow's classic leaves off with Morgan as the pre-eminent bank of the twentieth century.[1] This book depicts the challenges its leaders—Lew Preston and Dennis Weatherstone—confronted when Morgan's business model was disrupted in the early 1980s by the developing country debt crisis and premier corporate borrowers increasingly accessing capital markets.

As Morgan navigated around Glass-Steagall barriers to enter new lines of business, Preston and Weatherstone sought to ensure Morgan would remain a leading wholesale bank serving multinational corporations. Opportunities to grow through acquisition were presented and considered, including purchasing a stake in Citibank in the early 1990s. However, they were reluctant to integrate areas unfamiliar to Morgan such as retail banking or to assimilate cultures that were disparate from the firm's. In doing so, they defied all odds by developing Morgan's capabilities organically, whereas rival institutions expanded via a series of mega-mergers.

This book explores whether Morgan could have stayed independent had its leaders pursued the strategic plan that called for it to make targeted acquisitions in areas such as global custody, asset management and private banking where it had well-established businesses. The plan was to generate a steady revenue stream to help finance the expansion into securities. However, they passed on every opportunity, which left Morgan's earnings heavily dependent on volatile trading revenues.

[1] Ron Chernow, *The House of Morgan*, Simon and Schuster Inc., 1990.

When Sandy Warner became CEO in 1995, the tables had turned, and Morgan went from being the hunter to the hunted. Rival banks that had been burdened by bad loans to developing countries and commercial real estate capitalized on rising share prices during the tech boom and wave of leveraged buyouts (LBOs) to acquire other institutions. Meanwhile, Morgan's profits and share price lagged, which left it vulnerable to being acquired. When senior management unveiled a plan to enter the mass affluent market at a gathering of managing directors (MDs) in January 2000, it turned out to be "too little, too late."

I was motivated to write this book after attending a gathering of Morgan alums from around the world in London in July 2018. Many attendees had not seen one another since Morgan merged with Chase in September 2000. As the conversations invariably turned to reminiscing about the "good old days," some contended Morgan's strategy was flawed and they lamented the loss of the culture they cherished.

As I researched the topic, however, it became evident that all of the leading financial institutions struggled to change their business models. In the end, no US money center bank was able to complete the transition to become a universal bank on its own. What ensued was a growing concentration of assets in a handful of financial institutions that was a precursor to the 2008 financial crisis.

In assessing Morgan's strategy, therefore, I examined the sweeping changes in the US banking system. The seminal study was an article published by Brookings in 1995 that depicted the transformation and "long, strange trip" that had occurred from 1979 to 1994.[2] It called the period the "most turbulent in US banking history since the Great Depression" due to record numbers of bank failures and consolidations.

Ten years later, researchers at the Federal Deposit Insurance Corporation (FDIC) updated the Brookings study to cover thrift institutions and commercial banks for the period from end-1984 through 2003.[3] One of the main findings was that forces driving the wave of mergers had changed over time. During the 1980s banks struggled in a turbulent economic environment, and they sought to expand their geographic footprint in retail banking as regulatory barriers came down. By comparison, the mid- to late 1990s was more profitable for financial institutions, and many used their rising share prices to purchase other institutions including non-banks as Glass-Steagall prohibitions were relaxed.

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[2] Allen N. Berger, Anil K. Kashyap, Joseph M. Scalise, "The Transformation of the U.S. Banking Industry: What a Long, Strange Trip It's Been," *Brookings Papers on Economic Activity*, 2:1995.

[3] Kenneth D. Jones and Tim Critchfield, "Consolidation in the U.S. Banking Industry: Is the 'Long, Strange Trip' About to End?" FDIC Banking Review, February 2005.

Throughout this period there was an extensive debate among economists and policymakers about whether the growing concentration of assets by the largest institutions was desirable. The prevailing view was the US banking system was too fragmented and inefficient, and that consolidation would lead to a more efficient system. However, the evidence from empirical studies was mixed, and several studies sought to examine the impact on lending to individuals and small businesses. In the aftermath of the 2008 financial crisis, the debate has centered on whether the largest institutions have become "Too Big to Fail" and whether they should be broken up.

So, where does Morgan fit into this picture?

My answer is that Morgan stood out as the only financial institution to become a universal bank entirely on its own. In doing so, it sought to maintain its culture and to serve its corporate customers as a fiduciary, rather than become a financial super-market that was bigger and more complex.

While Morgan ultimately fell short of the goal of remaining independent, it did not require federal assistance at any point. The reasons: It had a solid balance sheet, was adept at handling market volatility and was prudently managed. These characteristics would serve the merged bank well during and after the 2008 crisis, when it attracted massive deposits and assets from individuals and corporations seeking a safe haven.

In the end, the foundation was laid for JPMorgan Chase to emerge as the world's pre-eminent financial institution under Jamie Dimon, who successfully integrated wholesale, retail and investment banking. In this regard, Dimon and his team have been able to accomplish what others in the banking industry strived for but fell short. Still, while Morgan alums today are proud of the firm's revival, many cling to the days when "Morgan was Morgan" and had a unique culture they cherished.

This book is organized in four parts. The first part, "Glory Days," presents a first-hand account of what Morgan was like in the late 1970s, as well as the developing country debt crisis in 1982 that disrupted Morgan's business model. The second, "Formulating the Plan," depicts the strategy that was developed in the second half of the 1980s to transform Morgan into a universal bank with investment banking and securities capabilities. The third, "Executing the Plan," describes the successes and challenges implementing the strategic plan in the first half of the 1990s. The fourth, "Playing Defense," depicts the events leading to Morgan being acquired by Chase. The final chapter focuses on the issue of "Why Morgan Matters" and Morgan's revival under Jamie Dimon.

This book is a personal account of what occurred while I worked at Morgan on two separate occasions: 1978–83 when it became embroiled in the Less

Developed Country debt crisis and 1995–mid-2003 when it merged with Chase. In the interim, I observed Morgan's transformation as a competitor and client at Salomon Brothers and Prudential Insurance. In writing this book I interviewed former colleagues and senior executives at Morgan to gain their perspectives, and I also gained access to materials relating to plans to reorient the bank. While I am grateful for their assistance, they are not responsible for the content or conclusions.

Keswick, VA, USA
March 2020

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Acknowledgments

This book is a tribute to a unique institution, JPMorgan, and the people who made it special. While Morgan has been at the forefront of global finance for well over a century, little is known about how it was transformed to become a universal bank in the 1980s–90s and the events leading to it being acquired at the turn of the century. The topic came to mind when I left Morgan in 2003. I sent the initial chapters to Susan Bell and am grateful for her encouragement, but wound up putting this book on hold due to work responsibilities.

Over the years, my interest in Morgan was rekindled at annual gatherings with a group of close friends—Shom Bhattacharya, Scott Nycum, Lee Thistlethwaite and Bill Vogt. During these occasions we reminisced about Morgan and shared tales about our experiences and colleagues. John Olds, who headed Asia-Pacific in the 1980s and went on to oversee the bank's return to the securities business, assembled a strong team in the Private Bank in the mid-1990s while laying the foundation for its revival.

The decision to resume writing the book was made at a London gathering in July 2018 to celebrate Lee Thistlethwaite's seventieth birthday. The attendees included Morgan alums from five continents, many of whom spent their entire careers at the firm. What was particularly striking was the common bond we felt. When I mentioned writing a book to Scott Nycum, he urged me to do so because of my background in economics and finance and prior books I had written.

As I undertook the project, my goal was to present an objective portrayal of what happened to Morgan. In addition to those cited previously, I interviewed other senior executives and colleagues to get their perspectives. Contributions from Frank Arisman, the late Rimmer de Vries, Ramon de Oliveira, Phil DiIorio, John Gent, Owen Harper, Jamie Higgins, David Kelso, David

Lawrence, Zung Ngyuen, Susan Restler and Richard Zimmerman are included in this book. I also received insights about the Chase-Morgan merger from John Lipsky, who served as chief economist for Chase and JPMorgan Chase.

As I researched Morgan's transformation, I soon realized all major financial institutions adapted to changes in the regulatory environment that led to a wave of bank consolidations. I am grateful to Robert Z. Aliber, emeritus professor at the University of Chicago's Booth School of Business, and to my former boss, Dr. Henry Kaufman, for their perspectives. Professors Richard Sylla and Ingo Walter of the New York University's School Stern of Business also provided useful feedback.

I also wish to thank my editors at Palgrave Macmillan, Tula Weis and Lucy Kidwell, for their assistance, and Kathy Louden for preparing the manuscript. Judith Bishop provided careful editing of the manuscript and helpful suggestions even as she was writing a book of her own.

Finally, this book is dedicated to my four sons and their families. Hopefully, one day they will share it with my grandchildren when they ask, "What did grandpa do?"

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Part I

Glory Days

1

23 Wall Street

“There it is. The number 23 engraved in stone. No name. It must be the Morgan Guaranty Trust Company.” My first thoughts as I arrived for a job interview in the autumn of 1977, after I was contacted by a recruiter from Russell Reynolds about an opening in Morgan.

Being interested in US history, I was immediately struck by the significance of the setting. The House of Morgan formed the apex of a triangle that was flanked on one side by Federal Hall, where George Washington was inaugurated as president of the United States, and on the other by the New York Stock Exchange. This seemed fitting for a firm that financed governments and corporations and which had been considered the de facto central bank of the United States prior to the creation of the Federal Reserve (the Fed) in 1914. (See Box about 23 Wall Street at the end of this chapter.)

Once the door opened, one left the United States and entered a completely different world, one more European and cosmopolitan. The room was enormous, half a street block in one direction and a quarter in the other. Pristine white marble was everywhere—floors and walls—with rich, green brocade panels on the walls providing contrast. Looking up at the three-story ceiling there was an enormous crystal chandelier that hung in the middle of the lobby. “Must be Old World charm.” I certainly hadn’t seen anything like it on the West Coast.

The atmosphere was eerie. Rows of bankers sat behind luxurious roll-top desks in three distinct areas that were separated by marble railings. Some were talking with their colleagues; yet you couldn’t hear a sound. Even more amazing, there didn’t appear to be any customers. “What type of bank is this anyway?”

N. P. Sargen, *JPMorgan’s Fall and Revival*, https://doi.org/10.1007/978-3-030-47058-6_1

All of this made me apprehensive. Morgan, after all, had the reputation of being the bank for the world's elite and an exclusive club for its employees. Its chairman and CEO Elmore "Pat" Patterson attended the University of Chicago, where he was captain of the football team. He was chosen to head the general banking division following the merger of Morgan with the Guaranty Trust Company in 1959, and he subsequently served as the head of the firm from 1972 to 1977.

Patterson played the dual role of many of his predecessors—first overseeing the bank while also playing a leadership role in ensuring the safety and soundness of the financial system. During the New York City financial troubles of the mid-1970s, he was instrumental in shaping the financial community's response along with David Rockefeller of Chase Manhattan and Walter Wriston of First National City (later Citibank).

Morgan Guaranty's president, Walter Hines Page, came from a prominent family, in which his father served as Ambassador to Great Britain. He also married the grand-daughter of J.P. Morgan and was the last partner to serve with him. Page's background included extensive international experience. During the 1960s he helped set up Morgan's offices in Frankfurt, Rome and Tokyo. Then, following the first oil shock in the early 1970s, he helped devise a plan for the creation of Saudi International Bank, and he maintained close ties with the Saudi Arabia Monetary Authority (SAMA), the country's central bank. By the time of my interview, it was announced that Page would replace Patterson as chairman and CEO and Lewis T. Preston would become president.

Considering the pedigree of Morgan's leaders and senior managers, I wondered whether I would fit into such a prestigious organization given my modest roots. Before accepting the interview I solicited the advice of Robert Aliber, a renowned professor of international finance, who was a visiting scholar at the San Francisco Fed while on leave from the University of Chicago's business school. Bob encouraged me to seek out the opportunity, as he thought very highly of Morgan and its people.

To reach the point of being considered for a position in the International Economics Department, I first had to clear two hurdles—an intelligence test and a personality profile. Taking the tests first thing in the morning was tough, as I had been wined and dined by a headhunter the previous night and was suffering from a bad case of West Coast jet lag. When I had difficulty answering the first five questions on the test, I started to panic. How humiliating—a Stanford Ph.D. who flunked a routine test of math and verbal skills! Oh well, at least I made it through twenty years of school and six years of government experience before being exposed.

I managed to calm myself after answering the next few questions and began to get back into my old test taking rhythm. By the time the psychology test came, I was in full stride and ready to outsmart the evaluators. One question asked how you would react if you found a bird on the ground with a broken wing. I rejected the two extreme answers: (1) put the bird out of its misery and (2) feel melancholy, but don't touch it. I opted to help the bird, which was the safe answer I thought a corporation would want.

After finishing the tests, there was a round of interviews. The first was with Dennis Weatherstone, the treasurer of the company. A short gentleman with a trace of a British accent greeted me in the reception area and escorted me to the treasurer's office. I presumed he was an administrative aide because he was very genial and unassuming. I soon realized my mistake, however, when he sat behind the desk.

I came away from the interview not only taken by Weatherstone's hospitality, but also with his intelligence and market savvy. Bob Aliber had told me Weatherstone was one of the most astute currency traders in the business, and he lived up to those high expectations.

Prior to becoming treasurer, Weatherstone headed the foreign exchange area of the firm, and most of our conversation was spent discussing exchange rate issues. I subsequently learned from others how he was admired as a British version of Horatio Alger. Weatherstone began his career as a clerk in the London office in the late 1940s and became a foreign exchange trader after receiving one of the highest scores in an exam. He subsequently became one of the firm's most successful traders and was appointed to head the area by Lewis T. Preston, who ran the London office in the mid-1960s. Thereafter, Weatherstone's career tracked Preston's closely. This was reassuring to me, as it provided concrete evidence that you did not have to be a blue-blood to be successful at Morgan.

My next interview was with Bruce Brackenridge, who headed the administration division and previously served as the senior credit officer for the bank. Brackenridge, who was a classmate of Bob Aliber at Williams College, asked me about him and we exchanged pleasantries. The conversation then turned to Morgan's involvement in lending to governments of developing countries. He was excited about their prospects and Morgan's role in financing them, and he drew parallels with the role British entities played in financing US railroads in the mid-nineteenth century. He then asked about my work in developing a risk appraisal system for assessing country credits at the US Treasury and the San Francisco Fed. At the end of the conversation he mentioned that I was being considered for a similar role at the bank.

The next stop was with Jack Noyes, Morgan's chief economist. Prior to joining Morgan, Noyes headed the Research Division of the Board of Governors of the Federal Reserve System. It was reassuring that someone with such a prominent position at the Fed would be willing to give it up to head economic research at Morgan. After Noyes compared Morgan and the Fed, I felt more comfortable about the transition I was contemplating.

Noyes oversaw the bank's publication, *The Morgan Guaranty Survey*, which was edited by Milton Hudson and widely followed in the financial community and by policymakers. When I asked about his views on the US economy, he gave a very balanced response: On one hand, the economy was growing at a healthy clip; on the other hand, inflation was showing signs of accelerating, which was a problem. Later, a Morgan employee told me my first Wall Street joke about two-handed economists: Noyes' name really meant NoYes—get it? I got it.

The most memorable part of the interview occurred at the end, when Noyes showed me the chartroom where Morgan's economists conducted briefings for clients. Once he turned on the lights, I was overwhelmed by how ultra-modern the room was. My first impression was that it was small movie theater, with plush seats and carpet that were a shade of "bordello purple." The two side walls were filled with lighted panels that displayed charts of US and international economic indicators, and additional slides were displayed on a screen next to the podium. Noyes mentioned that bankers liked to bring clients to the room to impress them about Morgan's state-of-the-art coverage of the global economies and financial markets.

The climax of the day was my meeting with the head of the International Economics Department and my prospective boss, Rimmer de Vries. As the editor of *World Financial Markets* (WFM), Morgan's flagship publication, Rimmer was the best-known international economist on Wall Street. An interview with the *New York Times* about the fallout from the second oil shock described him as follows:

> One of the most knowledgeable analysts of the international financial scene is Rimmer de Vries, senior vice president and chief international economist for the Morgan Guaranty Trust Company. Mr. DeVries, a crusty Dutch-born economist, is frequently sought out by United States Government officials and central bankers around the world. Morgan's monthly World Financial Markets produced under his guidance, is considered one of the most authoritative publications on international finance in the country. Mr. DeVries, like many others, is worried.[1]

[1] "Talking Business with Rimmer de Vries of Morgan Guaranty," Nov. 15, 1979.

I read WFM regularly while I was at the Treasury and Fed and was impressed by how informative and influential it was. The idea that I could contribute to a publication that was read by officials, business leaders and academics around the world definitely appealed.

The interview with Rimmer was different from the others. His office was at the end of a long corridor that was flanked by two rows of economists who sat behind elegant desks. No one spoke as I passed by, and it seemed as if I was back in Europe again. Suddenly, a voice from the back boomed, DAVID!!! and one of the economists went scurrying in to the office.

When I arrived at the door, a lanky Dutchman greeted me and introduced me to his colleagues, who were making final edits for the next issue of WFM. Rimmer explained the issue would discuss the worsening US trade situation and its implications for the dollar. He said he was concerned that the dollar was likely to depreciate significantly if US policymakers did not heed warning signs about impending inflation.

When Rimmer asked what my views were, I was unsure if he wanted to know what I really thought, or if he was fishing for information about what the Fed believed. He had a reputation for being able to get information out of officials, even when they did not intend to disclose it. I decided to play it safe and gave him the official party line. I answered that the dollar was not a major risk, because inflation was under control and overseas investors were still eager to provide financing for the US trade deficit. My own personal view was that inflation was beginning to heat up and interest rates were about to rise; hence I had refinanced my mortgage.

Rimmer next asked several questions about my personal background. I mentioned that my father was a Greek immigrant, and he asked if I was raised Greek Orthodox. (That was permissible then.) I told him I resisted learning Greek in my youth, and that my parents sent me to a near-by Lutheran grammar school. Rimmer seemed pleased by this, as the Lutheran Church and Dutch Reformed Church, of which he was an elder, followed similar precepts. The next question caught me off guard, "Were the children being raised Lutheran?" "No, my wife's Episcopalian," I answered. I could see the disappointment on his face.

Just when I thought I failed the final screen, Rimmer burst into spontaneous laughter. He held out his hand and indicated he would make me a formal offer if I was interested. I told him I was definitely interested in the job, but my wife, Susan, and I were both from the West and were nervous about moving to the New York area. The headhunter who contacted me about the position suggested I consider living in northern New Jersey, because of its easy access to Wall Street by train. However, based on jokes I heard about the state, I wasn't sure about raising a family there.

Rimmer seized on this, inviting me to visit his home in Oldwick, New Jersey, before I returned to the West Coast. He explained the town had been established by Dutch settlers 200 years ago and retained its original charm. I took him up on the offer, as I was curious to see what New Jersey was really like.

Upon arriving at his farm the next day, Rimmer was tilling his garden in the rain wearing wooden Dutch shoes. He mentioned that he had enough acreage cultivated to feed his family, as well as to sell produce to his neighbors and Morgan colleagues, for which he charged a reasonable price. After visiting with him, I came away impressed that Wall Street's top international economist could literally be so down to earth.

On my flight back to the West Coast, the fun part of the job search was over—flying to New York, being wined and dined and meeting interesting people. The hard part—deciding what to do—was just beginning. And I would have to give Morgan my answer in just two weeks.

Given my training in economics, I started by listing the pluses and minuses of taking the job and moving my family to New York. However, it was a futile exercise. The decision was really about choosing a career or a lifestyle. If it was simply a matter of picking the best paying job or the one with the best opportunity for advancement, Morgan was the clear choice. But my wife and I were both born and raised in the West, our families and friends were there, and Wall Street was a completely different world from the one we knew and liked.

When I told my colleagues at the San Francisco Fed about the offer, they were happy for me, but also raised another doubt. Was I ready to give up a career in economic research to become a "business economist"? Within the economics profession, the pecking order in terms of prestige was academics first, government second and business last. Was I ready to sink that low within my own profession?

My wife and I decided to visit her family in the Lake Tahoe area on the final weekend. The setting was spectacular—glorious Indian summer weather with cloudless blue skies, turquoise water, green pine trees. What more could anyone want in life?

As we headed off for the Bay Area, my wife's family looked at us sadly, realizing this could be the last time they could be close to us and their grandchildren. While I was driving, my stomach tightened, as I had less than 24 hours to go and still couldn't decide.

When we arrived home, I told my wife the decision was impossible; therefore, we should therefore let fate decide. I would toss a quarter, and we would go east if it came up tails and stay in the west if it was heads. When the toss came up tails, we agreed to make it two out of three. The second toss was heads. On the third throw, the coin spun endlessly on the hardwood floor, before finally settling on its edge in the corner of the room. What now???

Just when the situation seemed hopeless, I realized I needed outside counsel. I decided to contact Bob Aliber for his advice. When I spoke to Bob, I asked him to help me resolve the dilemma of choosing between career and lifestyle. "Easy—Nick, you're too young to retire." Put that way, the decision suddenly seemed obvious, and the knot in my stomach began to go away. The next morning, I called Morgan and accepted the offer.

Box: Background on "The Corner"

Owing to the popularity of Morgan's history, three retired officers-directors who played key roles at the bank from the 1920s assembled their recollections in a manuscript titled *Some Comments About The Morgan Bank* that was originally published in September 1979.[2] The manuscript contains a brief history of Morgan, and it also includes an Epilogue titled "The Corner" about the significance of 23 Wall Street location.

The building was completed in 1914, the year after the bank's founder, the elder J.P. Morgan, died. The cornerstone contains a copper box that includes a copy of the firm's articles of partnership, sample forms used for issuing travelers' letters of credit and a copy of the founder's will, in which he bequeathed one year's salary to each member of its staff. It also includes a copy of J.P. Morgan's testimony in 1912 to the Pujo Committee. It was formed to investigate the so-called money trust, a community of Wall Street bankers and financiers that exerted powerful control over the nation's finances.

What the cornerstone also contains, but is not mentioned in the commentary, is J.P. Morgan's motivation for building its headquarters on the historic corner opposite the New York Stock Exchange and Federal Hall. By constructing an edifice that is much smaller than surrounding buildings, he let clients know in a subtle way that he could afford to do so, and their money was in safe hands.

One of the most memorable events occurred on September 16, 1920. At noon when lunchtime crowds were crowding the streets, a huge bomb exploded in Wall Street next to the bank's headquarters, in which thirty people were killed and hundreds wounded. The police subsequently determined that a massive charge of TNT had been detonated in a horse-drawn wagon. The dents in the blocks of Tennessee marble on the Wall Street side of "The Corner" remains as a testimony to the power of the blast. While it was a premeditated crime that some attributed to "Bolsheviks," the mystery of who committed it and why was never solved.

[2] The authors are Longstreet Hinton, who joined the bank in 1923 and who went on to build its Trust Department, John M. Meyer, Jr., who began his career at the bank in 1927 and went on to be a revered chairman in 1969, and Thomas Rudd, who arrived in 1935 and became a senior officer.

2

A Private Club

As I headed for my first day of work on Wall Street at the start of 1978, I had overcome most of my angst about leaving the West Coast for life in the Big Apple. I also was comfortable about joining the House of Morgan. When I told family members and friends about my decision, they assured me that Morgan was the best bank in the world and "a class act."

I knew the history of Julius Pierpont Morgan and his involvement in financing American railroads and shaping the steel industry in the second half of the nineteenth century. What really fascinated me, however, was the role the House of Morgan played as a financial advisor to governments and as a quasi-central bank. In 1907, J.P. Morgan rescued the US financial system when he organized a consortium of US banks to provide financing to halt a run on several prominent trust banks and to provide liquidity to several key brokerage houses.[1] Seventy years later, government officials still sought the firm's counsel: A bank examiner at the San Francisco Fed told me the chairman of Morgan always received the first call from the Federal Reserve when problems arose in the financial system.

Aside from these accounts, I knew relatively little about what it was like to work for Morgan. I later realized this partly stemmed from the bank's aversion to any publicity. J.P. Morgan allegedly decided against putting the firm's name on its headquarters, because he believed anyone who didn't know the location shouldn't be a client. Nor did the firm advertise to gain new clients or business. Employees were allowed to speak to the press if they received prior

[1] See Robert F. Bruner, Sean D. Carr, *The Panic of 1907: Lessons Learned from the Market's Perfect Storm,* Wiley, 2007.

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