The Deal

REPRINT FROM JUNE 23, 2023

Q&A: RODGE COHEN REFLECTS ON BANKING CRISIS, CONSOLIDATION - PART 1

In the first part of a two-part interview, Sullivan & Cromwell's Rodge Cohen discusses the New York City bailout of 1975, the S&L crisis and the changes in bank regulation in the 1970s and 1980s.

BY DAVID MARCUS

This spring's bank failures had a familiar feel for H. Rodgin Cohen, the senior chair of Sullivan & Cromwell LLP. Since he started practice in 1970, Cohen has had a critical role in helping clients work through a series of financial crises, starting with the collapse of New York's Franklin National Bank in 1974 and including the New York City bailout of 1975; the savings and loan crisis in the 1980s; the stock market crash of 1987; and the near-collapse of the U.S. financial system in 2008.

"The players may change. The facts are not going to be identical, but there is so much similarity as to what happens, as well as differences," Cohen said of the collapses of Silicon Valley Bank, Signature Bank and First Republic Bank.

Sullivan & Cromwell's H. Rodgin Cohen

Cohen also advised commercial bank clients on the wave of M&A that consolidated the sector from the 1970s to 2008. He both saw and has helped shape the evolution of state and federal regulation of financial institutions from the 1970s onwards, and since 2008, he's helped clients navigate a much more aggressive regulatory environment.

Cohen discussed those topics in an extended interview with The Deal at Sullivan & Cromwell's New York office on June 2. The first part of an edited and slightly condensed version of the conversation follows.

The Deal: Why did you decide to go into a practice focused on financial institutions, and what was that practice when you started in 1970 and in the early years of your career?

Cohen: I'd like to invent some story about how I had this incredible prescient view of the world. The real answer is that I was interviewing off-cycle because I was in the Army, and about four or five weeks before I was ready to start, where I would have normally been just a normal corporate associate, for totally separate reasons two associates in the banking group, which I think were two of the four, left.

I received a call saying, "We'd really like you to do banking work." I said, "I don't know very much about it." They said, "We'll send you some reading material and you'll be fine." I was fascinated by the work. I got in on the ground floor in some ways. I enjoyed it and never left it.

Your practice evolved to have a very heavy regulatory

component, but was that regulatory component there when you were an associate?

It was by the end of the associate period. It was not as intensive as it is today. When I started, a fair amount of my practice was something I don't do anymore, which is bank lending. We did a fair amount of lending for our regular bank clients. There were regulatory issues, but again, not as intense.

I started in November of 1970, and about a month later, the Bank Holding Company Act amendments of 1970 were adopted. That revolutionized the regulatory structure because prior to those amendments, the Bank Holding Company Act applied to very few banking organizations. It applied only if you had multiple banks, and now it applied to everybody that owned a bank.

There were a number of issues which arose and we got involved in, and that led to more regulatory work. Then you have a few years later the International Banking Act of 1974. We did a lot of work with foreign banking organizations, and that led to a lot more regulatory work because for the first time there was federal regulation of foreign banks operating in this country. It was nascent, but there were the stirrings of bank merger activity even in the early and mid-1970s.

What was your client base at that point?

We did not then represent the very largest banks. We represented banks like Bank of New York, when it was a lender, and Marine Midland Banks, which was ultimately bought by HSBC. [HSBC Holdings plc bought a 51% stake in Marine Midland in 1980 and the rest of the bank in 1987.] I worked a fair amount for corporate clients when they were borrowing from banks.

Then there are episodic issues, which were very valuable learning experiences, at least for me. In the 1970s, we had the New York City fiscal crisis, where the banks played a major role. A number of young bankers who ultimately became very prominent were given the role by their respective executive management teams to run that.

Did you have a role in that?

We represented some of the banks. Because we represented what was then called the New York Clearing House, an association of the New York City banks that had been founded in the 1850s, I tended to have somewhat of a coordinating role assisting the partner who ran it, but I got to do a lot of the work.

The financial crisis in the mid-1970s in broad outline was that New York was at serious risk of going bankrupt, which was not good for financial services institutions in the city. At the time, there was a sense that New York was in a death spiral. Did the banks essentially provide a bailout of New York City?

It was in part. This was probably as good an example as I have ever seen of public-private cooperation. The Transport Workers Union was hard as nails, but they were constructive throughout and played a great role in the negotiations. The banks bought a ton of the bonds of the Municipal Assistance Corp., an organization established by New York state to issue bonds to help finance the city.

In legal terms, what did that involve for you, and what lessons did you take from that about managing financial distress?

In legal terms, to make sure the agreements worked and that they didn't wind up to the disadvantage of the clients. In terms of financial stress, it was clear that the more all the relevant parties could work together, the more likely you are to get to success. It took everybody working to advance the public interest.

In the late 1970s and early 1980s, there were dramatically rising interest rates, which made for a very challenging time for banks and the economy broadly. What pressures were banks feeling then? You mentioned earlier that you could see the beginnings of bank consolidation then. Even in the 1970s, were people starting to think that a banking system designed in the Depression needed to be completely overhauled?

By about the mid-1970s, banks were starting to expand in a number of ways, and this required their going to market to raise capital with a lot more regularity. In addition, the SEC had put out its first guide specifically for bank disclosure, what was designated as Guide 3. These all flow together, and by 1975 or so, I did a lot less bank lending and a lot more bank underwriting when the banks would go to market.

As to consolidation, in many ways, the system had been structured during the Depression, but the decision to limit banks to a single state or a single city and sometimes to a single branch office predates the Depression. No other industry has been limited geographically as to where they can be, so this was sort of an unnatural restraint that goes back well back in the 19th century. The original idea was that you didn't want banks to be too powerful, and one

way to keep them from being too powerful is to limit them geographically.

That was outmoded, and slowly but surely cities and states were beginning to figure out that this was not such a good idea anymore, to limit banks. As those restrictions started to be lifted, the banks grew both organically and inorganically into different geographic areas within states and later outside states.

States such as North Carolina and California had permitted banks to expand statewide. Their banks were growing very substantially, whereas in New York they were not. New York finally loosened its restrictions.

North Carolina allowed banks to operate statewide by 1975, which ultimately led to the creation of Bank of America and First Union. Was there a sense that there was going to be massive consolidation?

There were always three restraints. One was state law, one was federal law, and the other was an outmoded Department of Justice view as to competitive issues. By the 1970s, the Department of Justice was already coming to accept the realities of the U.S. economy, albeit belatedly, and the states and ultimately the federal government got there as well. Interstate banking was advanced in 1995 when the Comptroller of the Currency accepted our position that a bank could move its home office across state lines if the move did not exceed 50 miles.

What did your practice look like by 1980?

Bank acquisitions now were becoming feasible as a regulatory matter. At the risk of getting into the weeds, there had been this potential competition theory. Under this theory, banks couldn't expand even in areas where they had no presence, because the potential that someday they would open de novo purportedly had a positive effect on competition. In the 1960s, for example, JPMorgan & Co. tried to build a presence in upstate New York and buy a number of banks outside of New York City, including in Westchester County and Long Island, but they were rejected.

But when Bank of New York, which was much smaller and less influential than JPM, wanted to do so, we could get the green light. Some of our foreign bank clients came in and bought for the first time, too. Ultimately, the potential competition theory was abandoned.

In the 1980s there was the beginning of a more receptive approach to breaking down silos in the financial services industry. I spent considerable time working on Mellon Bank Corp.'s acquisition of Dreyfus Corp., which was considered a breakthrough transaction at the time. [The deal closed in 1994.]

New York allowed statewide banking only in 1971. Through the 1980s, is the pace of bank M&A picking up? Then late in the decade, there's the savings and loan crisis.

Bank deals are turbo-charged because you have the state law changes, and you have some states that pass reciprocal statutes. State A says, "I'll let your banks come into my state if my banks can go into your state." There were the so-called interstate compacts that permitted a number of transactions in the Southeast and New England.

There are two other sets of financial crises before you get to the S&L crisis. The first is in the late 1970s and early 1980s, when the New York savings bank structure collapses. That was a thriving industry. In a close parallel to what happened this spring, savings banks were funded with relatively short-term deposits and they made very long-term loans, which is fine so long as there was a cap on the rate of interest they could pay on deposits. That cap was removed, interest rates rose sharply, and the whole industry collapsed in a few years.

In the mid 1980s, there were a number of incidents of financial crises. The Ohio thrift crisis. Continental Illinois goes down. There were rolling geographic bank crises due largely to the volatile nature of oil prices. The banking industry collapses in Texas, it collapses in Colorado, it collapses in Arizona, it collapses in Oklahoma, and now you come to the S&L crisis, which was a combination of the asset-liability mismatch and interest rate sensitivity and also the fact that a number of thrifts had engaged in very speculative lending.

What role did you play in that crisis? You worked for Continental Illinois. What happened to that bank?

It was quite an episode. Ultimately, there was a transaction reached where the FDIC provided some assistance and the FDIC was basically insulated from losing money. [That occurred in 1984.] But Continental was able to survive and ultimately was sold [in 1994 to Bank of America].

We worked for the state of Ohio during the thrift crisis [of 1985]. The governor [Richard Celeste], whom I did not previously know, called and asked if we could represent the state. Then the state legislature passed a law that helped an out-of-state bank buy the largest of those thrifts, and

there is support for the remaining thrifts. Ultimately, they pretty much disappear. But at least it stabilized the situation. So the role we have is varied.

How would you compare the Ohio situation and the situations in other states where the banking sectors collapsed to the New York City crisis?

I probably overly worry about the collateral consequences of collapse of the financial system. However, having read a fair amount about what happened in the Great Depression, I think the collapse of the banking system in 1929 to 1931 was a major contributing factor to the Depression, and a similar pattern occurred in earlier economic disruptions. You'll never know because it's the road not taken, but if the financial system isn't stabilized, there are potentially huge implications for the overall economy.

Was there a point in your career where you started reading that history and it resonated a lot more with you?

I would say it started with the first real large financial collapse, which was a bank in New York called Franklin National Bank [in 1974]. That illustrated the value of getting the banks to work together and the public and private sector to work together. Franklin couldn't be saved, but it could be wound down to the point where it could be purchased. But had it just collapsed, who else would it have taken with it? You saw that when you got into the 1980s in Texas. When one large bank in a market collapses, it puts enormous pressure on the others.

We saw that again this year, which must have resonated with you.

It did, very much so. ■

AS FEATURED ON The Deal
TheDeal.com (ISSN 1547-7584) is published by The Deal.
© Copyright 2023 The Deal. The Copyright Act of 1976 prohibits the reproduction by any means of any portion of this publication except with the permission of the publisher.