

# VANITY FAIR

## THE COLLAPSE



From left: former Bear Stearns C.E.O.'s Alan Schwartz, James Cayne, and Alan "Ace" Greenberg, in front of the firm's former headquarters, in New York City.

## Bringing Down Bear Stearns

On Monday, March 10, the rumor started: Bear Stearns was having liquidity problems. In fact, the maverick investment bank had around \$18 billion in cash reserves. But soon the speculation created its own reality, and the race was on to keep Bear's crisis from ravaging Wall Street. With the blow-by-blow from insiders, Bryan Burrough follows the players—Bear's stunned executives, trigger-happy reporters at CNBC, a nervous Fed, a shadowy group of short-sellers—in what some believe was the greatest financial scandal in history.

by **BRYAN BURROUGH** August 2008

On Monday, March 10, Wall Street was tense, as it had been for months. The mortgage market had crashed; major companies like Citigroup and Merrill Lynch had written off billions of dollars in bad loans. In what the economists called a "credit crisis," the big banks were so spooked they had all but stopped lending money, a trend which, if it continued, would spell disaster on 21st-century Wall Street, where trading firms routinely borrow as much as 50 times the cash in their accounts to trade complex financial instruments such as derivatives.

Still, as he drove in from his Connecticut home to the glass-sheathed Midtown Manhattan headquarters of Bear Stearns, Sam Molinaro wasn't expecting trouble. Molinaro, 50, Bear's popular chief financial officer, thought he could spot the first rays of daylight at the end of nine solid months of nonstop crisis. The nation's fifth-largest investment bank, known for its notoriously freewheeling—some would say maverick—culture, Bear had pledged

to fork over more than \$3 billion the previous summer to bail out one of its two hedge funds that had bet heavily on subprime loans. At the time, rumors flew it would go bankrupt. Bear's swashbuckling C.E.O., 74-year-old Jimmy Cayne, pilloried as a detached figure who played bridge and rounds of golf while his firm was in crisis, had been ousted in January. His replacement, an easygoing 58-year-old investment banker named Alan Schwartz, was down at the Breakers resort in Palm Beach that morning, rubbing elbows with News Corp.'s Rupert Murdoch and Viacom's Sumner Redstone at Bear's annual media conference.

It was an uneventful morning—at first. Molinaro sat in his sixth-floor corner office, overlooking Madison Avenue, catching up on paperwork after a week-long trip visiting European investors. Then, around 11, something happened. Exactly what, no one knows to this day. But Bear's stock began to fall. It was then, questioning his trading desks downstairs, that Molinaro first heard the rumor: Bear was having liquidity troubles, Wall Street's way of saying the firm was running out of money. Molinaro made a face. This was crazy. There was no liquidity problem. Bear had about \$18 billion in cash reserves.

Yet the whiff of gossip Molinaro heard that morning was the first tiny ripple in what within hours would grow into a tidal wave of rumor and speculation that would crash down upon Bear Stearns and, in the span of one fateful week, destroy a firm that had thrived on Wall Street since its founding, in 1923.

The fall of Bear Stearns wasn't just another financial collapse. There has never been anything on Wall Street to compare to it: a "run" on a major investment bank, caused in large part not by a criminal indictment or some mammoth quarterly loss but by rumor and innuendo that, as best one can tell, had little basis in fact. Bear had endured more than its share of self-inflicted wounds in the previous year, but there was no reason it had to die that week in March.

What happened? Was it death by natural causes, or was it, as some suspect, murder? More than a few veteran Wall Streeters believe an investigation by the Securities and Exchange Commission will uncover evidence that Bear was the victim of a gigantic "bear raid"—that is, a malicious attack brought by so-called short-sellers, the vultures of Wall Street, who make bets that a firm's stock will go down. It's a surprisingly difficult theory to prove, and nothing short of government subpoenas is likely to do it. Faced with a thicket of lawsuits and federal investigations, not a soul in Bear's boardroom will speak for the record, but on background, a few are finally ready to name names.

"I don't know of any firm, no matter the capital, that could have withstood that kind of bombardment by the shorts," says a vice-chairman of another major investment bank. "This was not about capital. It was about people losing confidence, spurred on by rumors fueled by people who had an interest in the fall of Bear Stearns."

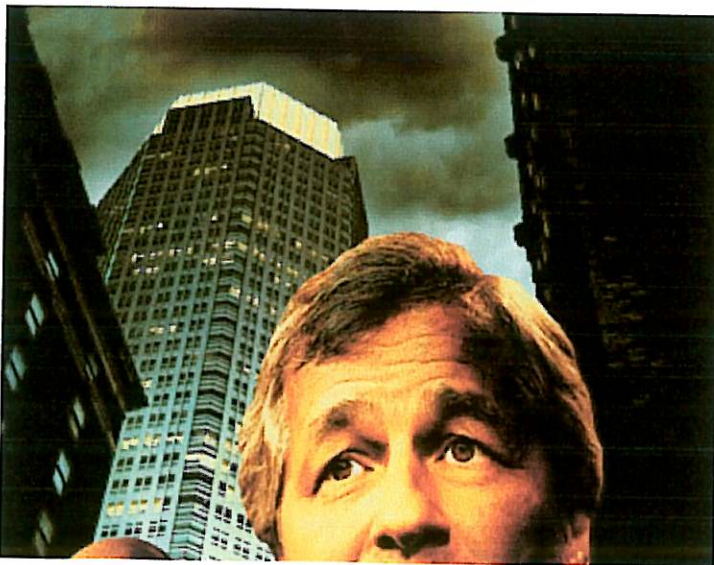
He pauses to let the idea sink in. "If I had to pick the biggest financial crime ever perpetuated," he concludes, "I would say, 'Bear Stearns.' "

**A**t Phi Kappa Wall Street, most of the frat boys are instantly recognizable. There's the big, backslapping Irishman, Merrill Lynch, the humorless grind, Goldman Sachs, and the straitlaced rich kid, Morgan Stanley. And then, off in the corner, wearing its beat-up leather jacket and nursing a cigarette, was the tough-guy loner, scrawny Bear Stearns, who disdained secret handshakes and towel snapping in favor of an extended middle finger toward pretty much everyone. Bear was bridge-and-tunnel and proud of it. Since the days when the Goldmans and Morgans cared mostly about hiring young men from the best families and schools, "the Bear," as old-timers still call it, cared about one thing and one thing only: making money. Brooklyn, Queens, or Poughkeepsie; City College, Hofstra, or Ohio State; Jew or Gentile—it didn't matter where you came from; if you could make money on the trading floor, Bear Stearns was the place for you. Its longtime chairman Alan "Ace" Greenberg even coined a name for his motley hires: P.S.D.'s, for poor, smart, and a deep desire to get rich.

Bear Stearns was an investment bank, but the traditional banking roles, such as advising on corporate mergers and trading stocks, were always an afterthought there. What the P.S.D.'s at Bear Stearns did best was trade bonds. The firm's executive history was the story of three bond traders, each with his own outsize personality. From the mid-1930s till the late 1970s, Bear was the province of Salim "Cy" Lewis, the cantankerous Wall Street legend who forged a cutthroat culture run less as a modern corporation than as a series of squabbling fiefdoms, each vying for his approval. Ace Greenberg, an avuncular sort who kept his desk on the trading floor and answered his own phone, took over after Lewis's death, in 1978, and while his edges were softer, Bear remained a Mametesque pressure cooker where top traders could pull down \$10 million a year while runners-up were tossed into the alley.

The third man, the one who oversaw Bear's demise after nudging Greenberg aside in 1993, was his longtime protégé, Jimmy Cayne. Cayne was a cigar-chomping kid from Chicago's South Side, who in his early years sold scrap metal for his father-in-law. After a divorce, he found himself driving a New York taxi while pursuing his beloved pastime, playing bridge. It was at a bridge table, in fact, that Greenberg, himself an ardent player, met Cayne and lured him to Bear Stearns. "If you can sell scrap metal," Bear lore quotes Greenberg telling Cayne, "you can sell bonds." Cayne found his life's calling on the trading floor, earning his bones by moving huge numbers of New York municipal bonds during the city's financial crisis of the 1970s. He became the embodiment of Bear Stearns, a go-it-alone maverick who hunkered down in his smoke-filled sixth-floor office, not giving a rat's ass what Wall Street thought so long as Bear made money. When an early hedge fund, Long-Term Capital Management, collapsed in 1998, losing \$4.6 billion and triggering fears of a global financial meltdown, Cayne famously refused to join the syndicate of Wall Street firms that bailed it out. Instead, while much of the Street reaped billions trading stocks during the booming 1990s, Cayne kept Bear focused on bonds and the grimier corners of Wall Street plumbing, clearing trades for just about anyone, however notorious their reputation.

Through it all, Bear remained proudly independent, refusing to sell out to larger firms. Cayne listened to lots of offers, especially after his pal Don Marron sold rival PaineWebber to U.B.S. for \$12 billion, in 2000, but Cayne preferred life as it was. Senior managers had wide autonomy, and in good years Bear all but ran itself, allowing Cayne to spend weeks away from his desk at bridge tournaments or playing golf near his vacation home on the Jersey Shore. In recent years much of the oversight fell to Cayne's two co-presidents, Alan Schwartz, a onetime pitcher at Duke University who specialized in media mergers, and another bridge aficionado, a talented trader named Warren Spector. Bear continued to thrive, piling up record profits all through the 2000s, and Bear's stock price rose nearly 600 percent during Cayne's 14 years as C.E.O.



From left: Treasury Secretary Henry Paulson, J. P. Morgan Chase C.E.O. Jamie Dimon, and Federal Reserve Chairman Ben Bernanke.

Eventually Bear, like most on Wall Street, branched into asset management, forming a series of large funds that put investor money to work in a variety of stocks, bonds, and derivatives. Unlike some firms, however, Bear promoted its own traders rather than outsiders to run these funds, and decided that each would specialize in a specific type of security, rather than a diversified mix. As co-president, Alan Schwartz, for one, questioned the move, thinking it was a bit risky, but deferred to the thinking of Spector and others.

Everything went swimmingly, in fact, until poor Ralph Cioffi ran into trouble.

Cioffi, 52, was a Bear lifer, a wisecracking salesman who commuted to Midtown from Tenafly, New Jersey, to oversee two hedge funds at Bear Stearns Asset Management, an affiliate known as B.S.A.M. His main fund, the High-Grade Structured Credit Strategies fund, plowed investor cash into complex derivatives backed by home mortgages. For years he was spectacularly profitable, posting average monthly gains of one percent or more. But as the housing market turned down in late 2006, his returns began to even out. Like many a Wall Street gambler before him, Cioffi decided to double-down, creating a second fund. Whereas the first borrowed, or “leveraged,” as much as 35 times its available money to trade, the new fund would borrow an astounding 100 times its cash.

It blew up in his face. As the housing market worsened during the winter of 2006–7, Cioffi’s returns for both funds plummeted. He urged investors to stay put, promising an imminent turnaround. (Cioffi and a colleague, Matthew Tannin, were indicted in June for misleading investors.) When the market downturn accelerated last spring, leaving Cioffi with billions of dollars in money-losing mortgage-backed securities no one would take off his hands, he concocted an audacious way to rescue himself, planning an initial offering for a new company called Everquest Financial that would sell its shares to the public. Everquest’s main asset, it turned out, was billions of dollars of Cioffi’s untradable securities, or, as Wall Street termed it, “toxic waste.”

Foisting his garbage onto the public might have worked, but financial journalists at *BusinessWeek* and *The Wall Street Journal* discovered the scheme in early June. Once the truth was out, B.S.A.M. had no choice but to withdraw Everquest’s offering, at which point Cioffi was all but doomed. Investors were beginning to flee. Worse, some of Cioffi’s biggest lenders, firms like Merrill Lynch and J. P. Morgan Chase, were threatening to seize his collateral, which was about \$1.2 billion. In a panic, Cioffi and his aides convened a meeting of creditors, where they asked for more time and more money. The gathering turned angry when several in the audience urged Bear to pony up its own money to save the funds, an alternative Bear executives dismissed out of hand.

Afterward, Warren Spector got on the phone with a series of Cioffi’s lenders, including a group of J. P. Morgan executives. “I’ll never forget this,” one recalls. “Spector gets on and goes, ‘You guys don’t know what you’re talking about—you don’t understand the business; only [Cioffi and colleagues] understand the business; only we are standing in the way of them finishing this [rescue] deal.’ ” It was a classic display of Bear-style arrogance, and it incensed the Morgan men. Steve Black, Morgan’s head of investment banking, telephoned Alan Schwartz and said, “This is bullshit. We’re defaulting you.”

Merrill Lynch, in fact, did confiscate Bear’s collateral—an aggressive and highly unusual move that forced Cayne into the unthinkable: using Bear’s own money, about \$1.6 billion, to bail out one of Cioffi’s two troubled funds, both of which ultimately filed for bankruptcy. It was a massive blow not only to Bear’s capital base but to its reputation on Wall Street. Inside the firm, much of the blame fell squarely on Spector, who oversaw Cioffi and other B.S.A.M. managers. “Whenever someone raised a question, Warren would always say, ‘Don’t worry about Ralph—he’ll be fine,’ ” one top Bear executive recalls. “Everybody assumed Warren knew what was going on. Well, later, after everything happened, Warren would say, ‘Well, I never knew his actual positions.’ It was one of those things where everyone thought someone else was paying attention.”

As one of Bear's lenders told me, "The B.S.A.M. situation confirmed to me my impression, which was that [Bear's] subsidiary businesses were run in silos—basically the guys ran their sub-businesses as they saw fit. So long as they were hitting their P&L targets, no one asked any real questions. To my mind, that contributed in a very large part to what happened later."

For the rest of the summer of 2007, Bear was buffeted by rumors that the bailout might force it into bankruptcy, or worse. For the most part, Cayne rode out the storm at the bridge table and his golf club, though by late July he began to sour on Spector. "Warren never showed any real remorse or contrition," says another Bear executive. "That just drove Jimmy mad." For three solid hours Alan Schwartz sat down with Cayne and argued against firing Spector, whom he genuinely liked, a conversation that ended when Cayne said of Spector, "Do you know he's never once said, 'I'm sorry'?" Schwartz replied, "That's kind of shocking."

Cayne forced Spector to resign on August 5. Bear Stearns had survived what many came to call a "near-death experience," but its troubles were only just beginning.

As summer turned to fall, mortgage-related losses hit scores of big banks just as they had Bear, yet Bear, for reasons that eluded Cayne and others, seemed to remain the poster boy for the credit crunch. Every story about other firms' losses seemed to carry a mention of Bear's, dredging up memories Bear executives would just as soon have buried. The perception of Bear's weakness put Cayne and Alan Schwartz in a bind. The bailout had blown a sizable hole in Bear's bottom line, and while the firm was in no immediate danger, everyone expected it would seek some kind of capital infusion.

Both Cayne and Schwartz, however, were deeply ambivalent about accepting a big chunk of money from another bank or private-equity fund. Cynics would later snipe that this was because Cayne didn't want to dilute his own substantial share of Bear's stock. In fact, it was more complicated. If they accepted outside help, Schwartz argued, they risked looking as if they needed it, which would only worsen the whispers about their financial health. In those early weeks of fall, Cayne and Schwartz engaged in a lengthy negotiation with private-equity veteran Henry Kravis in which he considered buying 20 percent of Bear's stock. The deal died, however, when Schwartz pointed out that Bear's own private-equity clients might not be thrilled to see Kravis on the board.

In the following months Cayne and Schwartz held a series of discussions with potential investors, at one point hiring a top investment banker, Gary Parr, of Lazard, to help out. There were discussions with private-equity investment company J. C. Flowers, a long set of talks with Jamie Dimon, J. P. Morgan Chase's C.E.O., who wasn't interested, and even a flirtation with legendary investor Warren Buffett that left Bear executives feeling Buffett was averse to risk. "Warren Buffett will only take nickels from dead people," one snipes. In the end, Cayne managed to arrange one deal: a strategic partnership with a leading Chinese securities firm, CITIC, which agreed to invest \$1 billion in Bear in return for Bear's investing \$1 billion with it. The market yawned.

Then, in November, came back-to-back body blows. On November 1, *The Wall Street Journal*, in a widely read front-page story, excoriated Cayne for his relaxed management style, portraying him as a bridge-crazy, pot-smoking Nero who fiddled while Bear burned. A few weeks later the firm was forced to disclose it would write down another \$1.2 billion (which ended up being \$1.9 billion) in mortgage-related securities and post the first quarterly loss in its history. The stock went into a prolonged dive—down 40 percent for the year. By January many executives were openly calling for Cayne's head. A few slipped into Schwartz's 42nd-floor office with an ultimatum: if Cayne wasn't gone by the time bonuses were paid in late January, they would leave. Schwartz was conflicted. He loved Cayne, but he couldn't afford to lose a group of top people, not at this point. He canvassed Bear's board, found them open to a change, then broke the news to Cayne himself. To Schwartz's surprise, Cayne took the news peacefully. He resigned as C.E.O. on January 8, but remained chairman of the board.

Schwartz was named the new C.E.O. His immediate priority was making sure Bear posted a profit in its current quarter, which ended February 29. There were still whispers out there about Bear's financial health, many fanned by rumors of federal investigations into the hedge-fund collapse, and Schwartz badly needed some good news to report. As mortgage-related losses struck firm after firm that winter, Schwartz kept his fingers crossed, watching the calendar tick off the days until February's end. He sweated out an entire extra day—leap day, February 29—but Bear made it. Preliminary figures showed they would report a quarterly profit of \$1.10 or so a share. With luck, Schwartz said, that would end the whispers.

Nevertheless, by Wednesday, March 5, Schwartz wasn't breathing any easier. The rumors continued, faint but insistent, now fueled by the troubles at a trio of hedge funds, Carlyle Capital, Peloton Partners, and Thornburg Mortgage. At a weekly risk-assessment meeting that day, Schwartz queried his people about Bear's exposure to the three funds, all of which were thought near collapse. Bear had lent to all three. Still, Bear's risk, Schwartz was told, was believed to be minimal.

The next day, Thursday, Schwartz flew to Palm Beach, where the firm's annual media conference was poised to start the following Monday at the Breakers hotel. The conference, one of Bear's best-attended events, brought together a host of media titans, many of them Schwartz's longtime clients: Murdoch, Redstone, Viacom's Philippe Dauman, Time Warner's Jeff Bewkes, Disney's Robert Iger. On Friday, while checking in with headquarters, Schwartz heard the rumors again, now a bit stronger: Bear was having liquidity problems. He trained his eye on a key auction of municipal bonds that Friday afternoon. Bear was providing \$2 billion in liquidity to various buyers. "That was the trip wire," another Bear executive recalls. "If anyone refused to take our name there, we knew we were in real trouble." All through the afternoon and into the evening, Schwartz monitored the note sales. To his relief, they went off without a hitch.

The storm struck full force without warning on Monday. That morning, when Sam Molinaro returned to his sixth-floor corner office from a week-long trip in Europe, he expected a normal day, nothing special; they would release the new, positive earnings the following week. After the trading day opened, at 9:30, one of the rating agencies, Moody's, downgraded another grouping of Bear's bonds. It was to be expected; the agency had been downgrading most of its offerings. Then, around 11, Bear's stock suddenly began to fall, gradually at first, then sharply. All the "financials"—Lehman, Merrill, Citi—were falling. Molinaro shrugged. But as he checked with the trading floor, he heard the rumors: Bear was having liquidity problems. Molinaro rolled his eyes. Not again.

Bear's P.R. man, Russell Sherman, heard the rumors, too. As the stock continued to slide, Sherman began calling reporters, trying in vain to pin down their source. As he did, Molinaro checked to see what could be fueling the rumor. Bear itself had no liquidity problem—he knew that. That morning the firm sat atop \$18 billion in cash reserves. Molinaro checked with his finance desk, the repo desk, his treasurer. Had anyone heard of anything like a margin call (in which a lender was demanding a huge chunk of cash back)? A trade gone bad? Was anything out of the ordinary? "Across the board, it was 'No, no, no, no—no problems,' " a Bear executive says.

At one point, Schwartz called in from Palm Beach to assess the situation. "I'm getting a little nervous," he said. Molinaro assured him there was no substance to the rumor.

At that point the rumor went public—on CNBC, the cable network that serves as Wall Street's daily backdrop. On every trading floor dozens of TV sets, mounted high on the walls, are perpetually tuned to the network, which runs nothing but shows about finance and money—from *Squawk Box* to *Closing Bell* to Jim Cramer's *Mad Money*.

By noon, when CNBC anchor Bill Griffeth opened *Power Lunch*, Bear's stock was down more than \$7, to \$63. "There are rumors out there that some unnamed Wall Street firm might be having liquidity problems," Griffeth

noted. A correspondent on the show, Dennis Kneale, a veteran of *The Wall Street Journal*, said, "The speculation at this point is that it's Bear Stearns. They're down the most in the market today. Supposedly, a couple of weeks ago, they started looking at a way to try to shop their clearing operations.... [They] couldn't find a buyer. At least that's what one guy says."

At Bear Stearns, 80-year-old Ace Greenberg was already pelting senior officials with phone calls, demanding that someone go public to rebut the rumor. "Ace was kind of freaking out that morning," one senior Bear executive says with a sigh. "He just couldn't contain himself."

A few minutes past 12, another CNBC correspondent, Michelle Caruso-Cabrera, reached Greenberg at Bear. He told her the rumor was "totally ridiculous." CNBC reported his comments within minutes, then incorporated them into a running headline—BEAR STEARNS' ACE GREENBERG TELLS CNBC LIQUIDITY RUMORS ARE "TOTALLY RIDICULOUS"—the rest of the hour. In his office, Molinaro saw the headline and fumed. Addressing the rumor at this stage, he and others felt, merely appeared to legitimize it.

From Palm Beach, Schwartz telephoned Greenberg in frustration. "Ace, you can't just do that!" he said.

"Well, I had to!" Greenberg replied.

Once the CNBC headline began running, reporters began calling Russell Sherman's office. Sherman told the Bloomberg reporter the rumor was untrue, but Bear's stock was going crazy. The total volume was over 50 million shares; on a normal day it might trade 7 million.

At a little after one CNBC correspondent Charlie Gasparino, an especially aggressive reporter who for months had been suggesting Bear's possible indictment on criminal charges in the hedge-fund collapse, joined an on-air roundtable to discuss the rumor. Gasparino was the bane of Bear Stearns; more than once he had predicted that the firm would go under. "I don't believe there is a liquidity problem at Bear Stearns," Gasparino said on-air. "Bear Stearns has a problem with whether they should exist or not in the future in this sense.... What do they have left? A clearing business, a second-rate investment bank?" If the credit crisis continued, Gasparino said a few moments later, "I don't see how they could survive independently. They don't have enough horses out there."

Sitting on a stool beside him, Bill Griffeth appeared startled at the strength of the statement.

"You're on record, then," he remarked.

Gasparino laughed. "Wouldn't be the first time I was wrong," he said.

**A**t Bear Stearns, no one was laughing. Publicly speculating on a firm's liquidity is akin to shouting "Fire!!!" in a crowded theater; in catastrophic cases it can trigger panic selling. It risks, in other words, becoming a self-fulfilling prophecy.

For the next hour the Bear Stearns rumor became a topic of conversation between CNBC correspondents and various market traders and analysts. At 1:50, Matthew Cheslock remarked, "The sentiment [on Bear] is pretty negative. The general consensus is 'Where there's smoke, there's fire.' "

A few minutes later, Griffeth, perhaps sensing the network might have gone a bit too far, asked Dennis Kneale, "What about the jittery nature of this market right now? Are we starting to believe some rumors that may or may not be true?" Kneale agreed. "Someone," he observed, "is always making money on the other side of that bad news or that rumor."

Yet CNBC's coverage remained anything but skeptical of the rumor. At two the network's new "money honey," Erin Burnett, headlined the hour by announcing "credit issues at Bear," never mind that there was no such thing. She turned to correspondent David Faber, who observed, "Of course, no firm's ever going to say that they are having trouble with liquidity, and, in fact, you've either got liquidity or you don't. So if you don't have it, you're done. Those are the kinds of concerns in this market, concerns of confidence.... You can have crises of confidence, causing meltdowns."

At 2:07 came shocking news: the first mention that New York governor Eliot Spitzer had had dealings with a prostitution ring. That news shoved Bear Stearns out of CNBC's headlines, much to the relief of the firm's executives. At day's end, Sherman issued a formal statement denying any liquidity problems. On Monday night, Schwartz and Molinaro held their breaths, hoping the worst was over.

In fact, it had just started.

**T**uesday morning the Federal Reserve announced a novel new securities lending program for major Wall Street firms to help them weather the credit crisis. Most financial stocks rebounded, but not Bear. After lunch, Gasparino went on-air and said the Fed initiative was being interpreted as an effort to save one firm—Bear. By early afternoon the rumors were once again flying, now stronger than ever.

The first to pull their money from Bear were several major hedge funds. So Molinaro and his men canvassed the repo lenders, which give banks billions of dollars in overnight loans that have to be renewed each day. However, Molinaro found that all planned to "roll over" Bear's loans the next morning. "Nobody was cutting us off," says a Bear executive involved in the events. "There was a lot of chatter, though. The hedge funds were agitated. That was concerning, because they could influence the outcome by pulling out cash balances."

That same day Bear executives noticed a worrisome development whose potential significance they would not appreciate for weeks. It involved an avalanche of what are called "novation" requests. When a firm wants to rid itself of a contract that carries credit risk with another firm, in this case Bear Stearns, it can either sell the contract back to Bear or, in a novation request, to a third firm for a fee. By Tuesday afternoon, three big Wall Street companies—Goldman Sachs, Credit Suisse, and Deutsche Bank—were experiencing a torrent of novation requests for Bear instruments. Alan Schwartz thought it strange that so many requests were being channeled to the same three firms, but did his best to assure them all that Bear remained on sound footing. "Deutsche Bank we talked to, and they said, 'We're getting killed!' " says a Bear executive. "We said, 'We'll take you out of your positions,' and we did. But it was too late."

Too late—because, before Bear could calm the waters, executives at both Goldman and Credit Suisse told their traders to hold up all novation requests dealing with Bear Stearns, pending approval by their credit departments. The Credit Suisse memo, a "blast" e-mail to much of its trading staff, quickly became the subject of widespread rumor and gossip. Both memos were essentially routine, a way to handle the deluge of novation requests rather than comments on Bear's viability, but they nevertheless served as the first concrete sign that some of Wall Street's biggest firms were having concerns about doing business with Bear.

**S**am Molinaro felt it was time for another public assurance. CNBC's Charlie Gasparino had been peppering him with phone calls seeking comment. Molinaro talked to Russell Sherman, who felt Gasparino could be played. "He'll say something negative if you shut him out. But if you talk to him, he'll go positive," one Bear executive told me.

Around three, Molinaro spoke to Gasparino, telling him, "I've spent all day trying to track down the source of the rumors, but they are false. There is no liquidity crisis. No margin calls. It's all nonsense." Gasparino's on-air comments were mild, but for the first time he raised the specter of a nightmare scenario: "They are really



worried about this inside [Bear], that these rumors are taking a very nasty turn, and they might cause a run on the bank.”

Still, by day’s end, there was no rush among Bear’s lenders to withdraw cash from the firm. At that point, this executive says, “the notion of a liquidity crisis seemed silly.”

That night Schwartz, Molinaro, and others discussed what to do. The talks centered on whether Schwartz should go public in an interview with CNBC. “We debated putting Alan on the air a long time,” says one board member. “Yes, it might draw attention to the rumors. But it would definitely answer the questions. Our view was: we had to get him out.”

Schwartz, though, wanted some assurances first. From experience, he knew he faced a risk in picking the wrong CNBC correspondent for the interview. All the network’s talent—Gasparino, Maria Bartiromo, Faber, Larry Kudlow—had requested the interview, and whoever didn’t get it, Schwartz feared, might retaliate on the air. “Each of these correspondents has his own producer, and they all seem to hate each other,” one Bear executive told me. “If you choose Faber, you know Bartiromo will bash you the next day.” Schwartz directed Russell Sherman to identify the CNBC executive who supervised the correspondents, explain the situation, and ask that the correspondents who didn’t get the interview refrain from attacks. Sherman, however, couldn’t identify a single CNBC executive who seemed to have control over the correspondents. “Everyone on Wall Street knows the joke,” says another Bear executive involved in the discussions. “At CNBC, there is simply no adult supervision.”

**I**n the end they chose the safest of the lot, Faber. Wednesday morning, all across Manhattan, Wall Street traders crowded around their monitors to see what Schwartz had to say. More than a few shook their heads that the Bear C.E.O. was not in his office, grappling with the emerging crisis, but in, of all places, Palm Beach! As a senior executive of one competing firm put it, “To come on CNBC from Palm Beach and, you know, tell everyone everything was going to be O.K., they had to be crazy.” (Schwartz was worried that an abrupt departure from his conference might raise even more questions.)

Faber’s first question was a bombshell. He told Schwartz he had direct knowledge of a trader—a single trader—whose credit department had held up a trade with Bear Stearns, citing concerns about its health. At Bear, many executives gasped. It was a killer statement: Faber was saying, in essence, that Bear’s status as a trader, the basis of its business, was in question. Schwartz answered as best he could, saying everything was fine; only later did Faber say on-air the trade in question had finally gone through. But the damage had been done.

“You knew right at that moment that Bear Stearns was dead, right at the moment he asked that question,” a Wall Street trader of 40 years told me. “Once you raise that idea, that the firm can’t follow through on a trade, it’s over. Faber killed him. He just killed him.”

At Bear Stearns, however, the sentiment on the sixth floor was that Schwartz had done a good job. The interview did nothing, however, to stop the rumors. When Schwartz returned to his office that afternoon, he tried calling customers, but nothing he did could stem the tide. By the end of the trading day, the first repo lenders had warned Molinaro they would not renew their loans the next morning.

“The tone of Wednesday afternoon was not positive—three days of rumors were starting to take their toll,” says a senior Bear executive. Mostly because of hedge-fund withdrawals, the firm’s reserves had shrunk to less than \$15 billion. That evening, meeting in Molinaro’s conference room, the chief financial officer told Schwartz they could probably replace those reserves the following day. If the repo lenders began backing out, though, they were in serious trouble. Schwartz had a long-standing emergency plan in place, involving the sale of Bear assets, and for the first time Molinaro pulled it out and began studying it in earnest. Schwartz, meanwhile, got on the phone

to Gary Parr at Lazard. They agreed to meet the next day. Late that night a Bear lawyer telephoned Tim Geithner, president of the New York Federal Reserve. He briefed him on Bear's plight and urged him to have the Fed accelerate its plan to provide liquidity to the market.

The next morning, on his drive in from Connecticut, Molinaro began calling the repo and finance desks to check the tone of their early calls. The *Journal* had a story suggesting that any number of Bear's lenders, including the all-important repo lenders, were growing nervous. Still, those first calls went as well as could be hoped. Other firms were still trading with Bear. Few of the repo lenders were talking about refusing to roll over their daily loans. "Thursday morning, things looked good," says one Bear executive.

Then, just as they had the day before, the rumors began to multiply—and with them the withdrawals. By midafternoon the dam was breaking. One by one, repo lenders began to jump ship. As word spread of the withdrawals, still more repo lenders turned tail. The hedge-fund cash was almost all gone. "A lot of people were pulling out," one Bear executive remembers. "The nail in the coffin was the repo capacity."

Molinaro and Robert Upton, Bear's treasurer, ended the day toting up the withdrawals. By five, Molinaro could see his worst fears had been realized. He picked up the phone and called Schwartz in his 42nd-floor office. "You need to get down here," he said.

The numbers, scribbled out on a yellow legal pad, told the story. Standing in Molinaro's conference room, Schwartz listened as Robert Upton guided them through the wreckage. A full \$30 billion or so of repo loans would not be rolled over the next morning. They might be able to replace maybe half that in the next day's market, but that would still leave Bear \$15 billion short of what it needed to make it through the day. By seven it was obvious they had only two options: an emergency cash infusion or a bankruptcy filing the next day. The one thing everyone agreed upon was the need for secrecy. "If word gets out, it might be the end," one participant recalls saying.

Schwartz was stricken. He had genuinely thought they would make it. By early evening, realizing that Bear's life expectancy might now be numbered not in days but hours, he hit the phones. The regulators—the S.E.C., Treasury, the Fed—had been watching the situation all day and were waiting when he called to brief them. Gary Parr, the Lazard banker, had already touched base with J. P. Morgan's C.E.O., Jamie Dimon, that afternoon, letting him know where Bear stood. J. P. Morgan was the obvious candidate for overnight cash. The two firms had long-standing ties. Their headquarters faced each other across 47th Street.

That day was Dimon's 52nd birthday, and he was celebrating with a quiet family dinner at Avra, a Greek restaurant on East 48th Street. He was irked when his private cell phone rang; it was to be used only in emergencies. On the line was Parr, who put Schwartz on as Dimon stepped outside onto the sidewalk. Schwartz quickly explained the depth of Bear's plight and said, "We really need help."

Still irked, Dimon said, "How much?"

"As much as 30 billion," Schwartz said.

"Alan, I can't do that," Dimon said. "It's too much."

"Well, could you guys buy us overnight?"

"I can't—that's impossible," Dimon replied. "There's no time to do the homework. We don't know the issues. I've got a board."

The people he should call, Dimon said, were at the Fed and the Treasury—the only place Bear could get \$30

billion overnight. Still, Dimon promised to see what he could do to help. He hung up and dialed Tim Geithner at the New York Fed downtown.

Twenty-first-century Wall Street is a highly interconnected world, with just about everyone lending billions of dollars to everyone else, and Geithner worried that Bear's collapse might trigger a domino effect, taking down scores of other firms around the world; he urged Dimon in the strongest terms to think about somehow helping Bear. "Tim, look, we can't do it alone," Dimon said. "Just do something to get them to the weekend. Then you'll have some time."

Dimon hung up, reluctantly realizing Morgan was in this, like it or not. He knew everyone involved would push Morgan to consider buying Bear, but while there were certain of its businesses he coveted—prime brokerage, energy, correspondent banking—he wasn't thrilled at the prospect of taking aboard its massive mortgage-related problems. Still, in short order, he dispatched a credit team of a half-dozen traders to Bear to begin looking at its books. Then he realized he had a problem.

It was Steve Black, his investment-banking chief. The Morgan man who probably knew Bear best, Black was on a family vacation on the Caribbean island of Anguilla. That evening, in fact, Black was looking forward to three days of peace and quiet with his wife, Debbie. At her insistence, he had left his cell phone at the hotel when they went for a late dinner at a beachside restaurant. Midway through their meal, Black looked up and saw a man marching toward the table.

"Oh, shit," Black said under his breath.

"Are you Mr. Black?" the man asked. When Black nodded, the man said, "I have an emergency call from your hotel."

Black told the hotel to have Dimon call him at the restaurant. He was waiting in its bustling kitchen when the phone rang. "It's for me," he told a cook. By nine Black was back in his hotel, orchestrating the teams beginning to study Bear's situation. A Morgan jet would arrive in the morning to ferry him back to New York.

The first team of Morgan executives reached Bear's sixth-floor executive suite around 11 that night. It didn't take long for them to realize the danger in what they were being asked to do. If Dimon lent Bear \$15 billion or so and the firm imploded the next day, they could lose it all. A little after midnight Dimon told Schwartz in a phone call, "We've got to get the Fed in on this."

Downtown, Tim Geithner was waiting when Dimon telephoned. Any bailout, Dimon reiterated, was too big, too risky, for Morgan to handle alone. Both men knew that meant only one thing: somehow Bear had to be given access to the Fed "window," that is, the spigot of cash that was available to the nation's commercial banks, but not its investment banks. The only way for the Fed to help, to give Bear access to the "window," was to lend Morgan the money, allowing the bank to act as a bridge across which the Fed cash could stream into Bear's vaults.

Geithner, quickly grasping the wisdom of the move, got on the phone with Washington, going through the details with the Fed's chairman, Ben Bernanke, and the Treasury secretary, Hank Paulson, and his counterparts at the S.E.C. If they could just get Bear through the next day, perhaps a bigger and better deal could be forged over the weekend. By two a.m. teams from the Fed and the S.E.C. had joined the Morgan bankers at Bear, poring over the numbers. In Molinaro's conference room, Schwartz and Molinaro paced, occasionally taking bites of cold pizza; their fate, they now realized, was largely out of their hands.

By four a.m. the outlines of a deal were taking shape. Morgan would give Bear a credit line; the money would

come from the Fed. It took three more hours for the details to be pounded out. At the last minute Morgan's general counsel, Stephen Cutler, inserted a line into the press release stating the credit line would be good for up to 28 days.

At Bear, Schwartz and Molinaro allowed themselves a few nervous smiles. They were saved—for 28 days. "We all thought this was a huge win," remembers one Bear executive. "We were all pretty pleased, thinking we had averted our potential deaths."

They wouldn't be so sanguine for long.

When the markets opened Friday morning, traders greeted the news from Bear with surprise but not, at least initially, with panic. For the first hour or so of trading, the stock remained where it had been the day before, in the low 60s. In Anguilla, Steve Black furrowed his brow. "This is nuts," he remarked to his wife as they headed for the airport. "No one understands what happened here. This stock should be half that." By the time the Blacks arrived at the airport, it was.

By four o'clock the firm's capital reserves, which had been \$18 billion that Monday, had dwindled to almost nothing. "The balances leaving was a flood," remembers one Bear executive. "By Friday afternoon we couldn't even keep track of the money going out. Friday afternoon, I have to say, caught everyone by surprise. Because Friday morning we thought we had bought some 'stop, look, and listen' time."

Gary Parr, meanwhile, was already on the phones, canvassing every prospective rescuer he could think of. Just about anything was on the table: a merger, a sale of prime brokerage or other valuable assets, even an outright sale of Bear itself. The only way to stop the run, everyone knew, was to find what Parr kept calling a "validating investor"—a big name, hopefully with big money, who would send a message that Bear was still solid. Warren Buffett, with his unmatched reputation for identifying value, was the ideal solution. "If Buffett had put in a hundred dollars, that would've been enough," says one person involved that day. "That would have sent the message." But there was no rush, at least not at first.

Around six Schwartz slipped into the back of a black town car for the drive home to Greenwich. Somehow Bear was still alive, if barely. Thanks to the Morgan credit line, they could probably open on Monday. Now he had 28 days—28 days to raise new capital, find a merger partner, or sell Bear outright. It wouldn't be easy, he knew, but it was doable. Then, as the car cruised northeast, Schwartz's phone rang. It was Tim Geithner of the Fed, with the Treasury secretary, Hank Paulson.

Paulson came right to the point. "You'll recall I told you when we cut this facility [that] your fate was no longer in your hands," he told Schwartz. "Well, we don't plan on being here on Sunday night like we were last night. You've got the weekend to do a deal with J. P. Morgan or anyone else you can find. But if you're not done by Monday, we're pulling the plug." And, like that, Bear's 28-day cushion evaporated. The Fed's credit line was good only till Sunday night.

Schwartz hung up the phone, stunned. He telephoned Molinaro, who was also on his way home, at that moment buying a cup of coffee at a rest stop on the Merritt Parkway. "You've got to be kidding me," Molinaro said.

To this day, top Bear officials aren't sure whether they misread the "28-day" language or whether Paulson simply had a change of heart after the events of Friday afternoon. "Everyone thought we had 28 days," says one senior Bear executive. "Do we think they thought that? We think so. But, look, when this was done, we just got a piece of paper that said, 'If you agree to this, you'll be O.K.' We signed. No one spent a lot of time going over all the little details."

In fact, no one—not even Federal Reserve officials—had been sure what the credit line or the “28-day” mention actually meant. “They took hope in that language,” says a Fed official. “I don’t know why they did. We made it very clear at the time, ‘This is not the be-all end-all.’ Then again, this whole thing was done so fast. We didn’t think through all the details of what would happen next.”

When Schwartz returned to his office Saturday morning, one of his first calls was to Geithner. He appealed for more time, explaining that Bear thought it had 28 days. Geithner held firm. Sunday night, he repeated. By that point, representatives of prospective suitors were already streaming through Bear’s hallways, poring over financial documents. Their efforts switched into overdrive as word spread of the Sunday deadline. A team from Flowers was there, a team representing Henry Kravis, plus another half-dozen or so groups from major banks. J. P. Morgan alone had 16 different teams meeting with all of Schwartz’s top people.

It was a sobering process: as the day wore on, the bidders began dropping out, one by one. Everyone had an excuse: they didn’t have the time or the money or the balls to do such a risky deal in so short a time. The two best possibilities, it appeared, were Morgan and Flowers. The latter told Parr on Saturday afternoon it was prepared to buy 90 percent of Bear for about \$30 billion, or \$28 a share—that is, if it could scrape up \$20 billion from a bank consortium by the next day. No one thought Flowers could possibly get such a deal done in time.

From the outset, Schwartz assumed Morgan was the bridegroom. Across the street, in Morgan’s eighth-floor executive suite, Jamie Dimon and Steve Black fielded nonstop reports from their due-diligence teams, now numbering more than 300 people. The key, everyone knew, was Bear’s mortgage “book,” that is, its inventory of mortgage-backed securities. Much of it was illiquid—it couldn’t be sold. How to value these Rube Goldberg devices was anyone’s guess. The more Black studied Bear’s book, the more worried he grew. He and another Morgan executive, Doug Braunstein, got on the phone with Schwartz and Parr that night and told them that, if Morgan did bid, it wouldn’t be much.

Bear’s stock had closed Friday at \$32. “The fact you’re at 32 doesn’t mean much at this point,” Black said. He suggested that a Morgan bid might be in the range of \$8 to \$12 a share. “We said, ‘That’s all there is, and that’s with a lack of due diligence and a lot of other issues,’ ” says a person involved in the call. “Alan asked, ‘Will you do it come hell or high water?’ That was their key issue.”

**A**t nightfall everyone hunkered down for long hours studying Bear’s numbers, especially its mortgage book. By dawn, however, many Morgan executives were having second thoughts. The more they studied the securities Bear owned, the worse it looked. Bear, for instance, had initially estimated it had \$120 billion in so-called risk-weighted assets, those that might go bad. By Sunday morning, Morgan executives felt the actual number was closer to \$220 billion.

“We all kind of slept on it,” says one executive involved in the talks, “or not slept on it, kind of closed our eyes for a half-hour, and realized that if you take a step back and remove yourself from the enormity of it, what we were being asked to take over, from a risk factor, was gargantuan.” And it wasn’t just the financial risk. The morning’s *New York Times* carried a piece on Bear, by veteran reporter Gretchen Morgenson, that dredged through all the seamiest aspects of Bear’s recent history. Steve Black walked around the eighth floor making sure everyone read it. “That article certainly had an impact on my thinking,” remembers one Morgan executive. “Just the reputational aspects of it, getting into bed with these people.” He shudders.

Dimon had to agree. It was just too much. Steve Black broke the news to Schwartz. “Whatever other things you are working on, you should actively pursue them,” he said. Downtown, at the Fed, Tim Geithner stepped out of his conference room to hear the news from Dimon. “I remember he came back in a minute later, with this look on his face that said, ‘Huh?’ ” recalls a member of the Fed team.

"They're not going to do it," Geithner said.

Geithner believed he couldn't let Bear die. The repercussions were unthinkable. "For the first time in history the entire world was looking at the failure of a major financial institution that could lead to a run on the entire world financial system," a Fed official recalls. "It was clear we couldn't let that happen."

Within minutes Geithner was back on the phone with Dimon. There ensued a series of conversations where, in one Fed official's words, "they kept saying, 'We're not going to do it,' and we kept saying, 'We really think you should do it.' This went on for hours. Finally, [the conversation] shifted to 'Well, maybe if.' They kept saying, 'We can't do this on our own.' " All through these talks, Geithner kept a nervous eye on the clock. The Australian markets opened at six on Sunday evening, New York time. They had to have some kind of deal by then or risk chaos.

Geithner had several long conversations with Ben Bernanke and Hank Paulson. There was never any serious question whether the Fed would help out. Even though it had never attempted anything like this before, there was ample precedent for the move; both the German and British central banks had stepped up to rescue institutions laid low by the mortgage crisis in just the last year. Still, the details took hours to unspool. At one point, Paulson had to sign a document confirming that, yes, in the event Bear defaulted on its securities, the American taxpayer would pay the tab.

Meanwhile, at Bear, Alan Schwartz, now merely a spectator at his firm's funeral, watched the clock. By one, Bear's board was in session, many of its members, including Jimmy Cayne, present by phone; Cayne was in Detroit at a bridge tournament. At one point, Schwartz took a call from Morgan executives, who told him that any bid was likely to be less than the \$8-to-\$12 range mentioned the night before. In fact, they suggested the likely number was \$4.

When Schwartz relayed the \$4 idea to his board, several, including Cayne, grew apoplectic. Cayne argued strenuously that Bear simply file for bankruptcy. "There were a lot of people at that point who were just saying, 'Fuck 'em—let's go 11,' " remembers one person in the boardroom. It was then that Gary Parr and the bankruptcy attorneys patiently explained that bankruptcy was actually not an option, not for a major securities firm. Changes to the bankruptcy code in 2005 would force federal regulators to take over customer accounts. All its securities would be subject to immediate seizure by creditors.

Slowly, the humiliating inevitability of a \$4-a-share buyout—for a firm whose shares had traded as high as \$170 the year before—sank in. It was at that point, midafternoon, that Treasury secretary Paulson twisted the knife. As the ranking politician involved in the deal, he was concerned with appearances—both how it would look that the federal government was bailing out a well-heeled investment bank at a time when normal Americans were losing their homes, and the appearance of something lawyers call "moral hazard," that is, the idea that a Bear deal, by appearing to "save" a bank whose poor judgment had pushed it to the brink of bankruptcy, might actually encourage risky behavior by other financial institutions. This deal, Paulson judged, had to hurt Bear. And it had to hurt badly.

Paulson and Tim Geithner telephoned Dimon at Morgan. He put them on speaker. Dimon said he was considering a price in the \$4-to-\$5 range. "That sounds high to me," Paulson said. "I think this should be done at a very low price." A little later, Morgan's Doug Braunstein reached Gary Parr at Bear. A formal offer would be forthcoming, Braunstein said. "The number's \$2," he said.

Parr nearly choked. "You can't mean that," he said.

He did. Schwartz took the news quietly, which was more than one could say about some of his board members.

Jimmy Cayne—whose 5.66 million shares, once worth nearly a billion, would now be worth less than \$12 million—swore he would never accept such a humiliating offer. “The people around the table, some of them, their net worth was being wiped out,” says one person who was in the room. “There was every emotion you can think of: sadness, anger. They saw the tragedy. But the bottom line was, you know, when they got in a pickle, Bear Stearns didn’t have many friends.”

Schwartz took a half-hour explaining that the board really had no choice. It was Morgan or bankruptcy, which would mean liquidation, putting 14,000 employees out of work by noon the next day. “What can I say?” he said at one point. “It’s better than nothing.”

And like that, with the signatures on an unprecedented merger agreement, a major American investment bank vanished, along with \$29 billion in shareholder value and the secure futures of 14,000 employees. In the following days the hallways of Bear Stearns & Co. erupted in rage. Longtime friends fumed and even screamed in Schwartz’s face—at a town-hall meeting he chaired, where one man hollered, “This is rape!”; in the hallway outside his office; even in the Bear gym. Shareholders were so angry that everyone was forced back to the negotiating table the next weekend, when Morgan and the Fed, in a second set of manic around-the-clock meetings, agreed to boost the price to \$10 a share. Yet, for all the anger, all the frustration, no one could answer the one question on everyone’s mind: How on earth had this happened?

Even among the circle of top executives who lived through that frantic week, no two people see the crisis at Bear the same way. Many, though, agree with some version of the scenario Alan Schwartz has come to believe. Yes, Schwartz tells friends, mistakes were made. Yes, the firm was financially weakened. But the more he learned about what had happened behind the scenes that week, the more Schwartz came to believe that Bear’s collapse was a pre-meditated attack orchestrated by market speculators who stood to profit from its demise. According to those Schwartz has briefed, these unnamed speculators—several now being investigated by the S.E.C.—employed a complex scheme to force a handful of major Wall Street firms to hold up trades with Bear, then leaked the news to the media, creating an artificial panic.

“Something happened Monday that triggered this mess,” says one Bear executive who has spoken to the S.E.C. “It was as though a computer virus had been launched. Where the hell was this coming from? Who started it? We tried, believe me, but we could not track it down. We know lots of big hedge funds were spreading rumors, but how can you pursue that? Only the S.E.C. can, and they’re all over this.”

At the heart of this theory are the “novation” requests that began to pick up steam that Tuesday and Wednesday. As Bear executives later analyzed these trades, they discovered the overwhelming majority had been made with just three firms: Goldman Sachs, Credit Suisse, and Deutsche Bank. Schwartz came to believe this was no accident. In his mind, the flood of novation requests was designed to force at least one of the three firms to put a temporary halt to accepting them, which is what happened: Goldman and Credit Suisse did. News of that halt not only swept Wall Street trading floors, it appeared to gain credence the next day when David Faber asked Schwartz about it on CNBC. “I like Faber, he’s a good guy, but I wonder if he ever asked himself, ‘Why is someone telling me this?’” a top Bear executive asks. “There was a reason this was leaked, and the reason is simple: someone wanted us to go down, and go down hard.” (Faber says his reporting was accurate, and arose from talks with a source he has known for 20 years.)

But who? According to one vague tale, initially picked up at Lehman Brothers, a group of hedge-fund managers actually celebrated Bear’s collapse at a breakfast that following Sunday morning and planned a similar assault on Lehman the next week. True or not, Bear executives repeated the story to the S.E.C., along with the names of the three firms it suspects were behind its demise. Two are hedge funds, Chicago-based Citadel, run by a trader named Ken Griffin, and SAC Capital Partners of Stamford, Connecticut, run by Steven

Cohen. (A spokesman for SAC Capital said the firm “vehemently denies” any suggestion that it played a role in Bear’s demise. A Citadel spokeswoman said, “These claims have no merit.”) The third suspect, at least in Bear executives’ minds, is one of its main competitors, Goldman Sachs. (“Goldman Sachs was supportive of Bear Stearns,” says a Goldman Sachs spokeswoman. “There is no foundation to rumors that we behaved otherwise.”)

Several Bear executives also named an individual they believed was spreading rumors about them that week, Jeff Dorman, who briefly served as global co-head of Bear’s prime brokerage business until resigning to take a similar position at Deutsche Bank last summer. “We heard Dorman was saying things last summer,” says a Bear executive. “At the time we reached out to Deutsche Bank and told them he better stop it.” (Asked about the allegation, a Deutsche Bank spokeswoman acknowledged that Bear had sent its executives a letter last August asking Dorman not to solicit its clients, as he had agreed upon leaving Bear. Deutsche Bank replied that he wasn’t. The exchange didn’t explicitly address what Dorman might have been saying about the firm, nor would the spokeswoman.)

Today, many of Bear Stearns’s former employees are out of work. The firm has effectively disappeared into the maw of J. P. Morgan along with a number of key executives, including Ace Greenberg, who became a Morgan vice-chairman, and Alan Schwartz, who will probably take a position in the investment-banking department.

Maybe the S.E.C. will figure out whether Bear was murdered. But maybe it won’t. Even those who believe the firm was the victim of a predatory raid have their doubts it can ever be proved.

“Even with subpoena power, I’m not sure the S.E.C. will get to the bottom of this, because the standard of proof is just so difficult,” says a vice-chairman at another major investment firm. “But I hope they do. Because you can look at this as just another run on a bank or as a seminal point in the financial history of this country that could bring about a change, perhaps a drastic change, in the way we govern financial markets. If there is a solution to this kind of thing, it must be found in the roots of what happened at Bear Stearns. Because otherwise, I can guarantee you, it will happen again somewhere else.”


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## The Lehman Lesson

**What went wrong with the storied investment-banking firm is a warning for all of Wall Street.**

By Allan Sloan and Roddy Boyd  
Last Updated: September 15, 2008: 8:13 AM EDT

(Fortune Magazine) -- The sad fate of Lehman Brothers is a cautionary tale of what's gone wrong with Wall Street.

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Lehman ended up on the financial scrapheap because it played - and ultimately lost - a dangerous game involving high-stakes bets and huge borrowings. The firm's reported profits grew nicely through last year. But to keep its profits growing, Lehman was taking on more and more risk.

Lehman ([LEH](#), [Fortune 500](#)) borrowed too much money, put too much of it into deals of dubious quality, and then insisted for months that all was well when it was apparent that all wasn't well. Monday's bankruptcy filing is a sad end for a firm once regarded as prudent and well managed.

The saddest thing of all is that decades ago Dick Fuld, now Lehman's CEO, bitterly opposed having the firm do big, aggressive deals with its own capital. But as we said in July, during one of Lehman's recurring crises, Fuld's decision to do the risky things that he opposed in the 1980s hurt Lehman badly.

Back then, Fuld's trading faction from the old Lehman Brothers was struggling against the firm's banker faction, led by Steve Schwarzman and Pete Peterson.

The bankers wanted the firm to use its own capital to do deals. The traders opposed it.

The trader-banker war so weakened Lehman that it sold out to American Express ([AXP](#), [Fortune 500](#)) in 1984. Fuld, a Lehman lifer, stayed on, while Schwarzman and Peterson went off to found the Blackstone Group ([BX](#)) and become billionaires.

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In 1994, AmEx, giving up its "financial supermarket" strategy, spun off a small, undercapitalized firm called Lehman Brothers, with Fuld as CEO. (That's why, despite what you read, Lehman wasn't a 158-year-old firm; it was a 14-year-old firm with a 158-year-old name.) Lehman's leverage - borrowings relative to capital - grew and grew, even as other firms were cutting back as the credit crunch worsened.

For example, last October, with the real estate collapse well underway, Lehman (in partnership with the Tishman Speyer real estate firm) paid a whopping \$22.2 billion to do a leveraged buyout of a big apartment developer, Archstone. Losses on the deal began to surface almost immediately. Alas, we can't give you Fuld's take on all this; he's declined to talk with us for months.

Lehman looked as if it would be able to survive more or less intact after the Federal Reserve Board announced in March that it would make huge loans available to eligible investment banks. This came shortly after the Fed and the Treasury forced a fire sale of Bear Stearns, and let it be known that the timing was no coincidence.

But Lehman never fully regained the market's confidence, Fed and Treasury support notwithstanding.

That leads us to a second Wall Street lesson from Lehman: that the Fed and Treasury can no longer control events as they once could.

*Reporter associate Beth Kowitt* ■

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[Putting lipstick on the subprime-mortgage pig](#)

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