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Bear CEO's Handling Of Crisis Raises Issues

Cayne on Golf Links,
10-Day Bridge Trip
Amid Summer Turmoil

By **KATE KELLY**
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A crisis at **Bear Stearns Cos.** this summer came to a head in July. Two Bear hedge funds were hemorrhaging value. Investors were clamoring to get their money back. Lenders to the funds were demanding more collateral. Eventually, both funds collapsed.

During 10 critical days of this crisis -- one of the worst in the securities firm's 84-year history -- Bear's chief executive wasn't near his Wall Street office. James Cayne was playing in a bridge tournament in Nashville, Tenn., without a cellphone or an email device. In one closely watched competition, his team placed in the top third.




James Cayne

As Bear's fund meltdown was helping spark this year's mortgage-market and credit convulsions, Mr. Cayne at times missed key events. At a tense August conference call with investors, he left after a few opening words and listeners didn't know when he returned. In summer weeks, he typically left the office on Thursday afternoon and spent Friday at his New Jersey golf club, out of touch for stretches, according to associates and golf records. In the critical month of July, he spent 10 of the 21 workdays out of the office, either at the bridge event or golfing, according to golf, bridge and hotel records.

Mr. Cayne evidently didn't court business on the links, as some CEOs do. "The golf course for him was an escape," says John Angelo, a hedge-fund client and frequent golf partner. Another golf partner, talk-show host Maury Povich, says: "Believe it or not, many words are not exchanged about business." During the bridge event, at a time when Bear's executive committee in New York was meeting almost daily, Mr. Cayne took part by phone, then played bridge most of the afternoon.

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In a short interview, Mr. Cayne declined to address his performance or his focus on Bear's summer crisis. Other Bear executives scoff at any notion that Mr. Cayne, 73 years old, isn't fully engaged. They say he reached out to clients this summer and has led by effectively delegating responsibilities to deputies.

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Vote: In light of his performance during Bear Stearns's summer crisis, should CEO James Cayne remain on the job?²

"Anyone who thinks that Jimmy Cayne isn't fired up every day and ready to get to work hasn't been living in my world," says Alan Schwartz, Bear's president. He notes that over Labor Day weekend, Mr. Cayne flew to China to help seal a partnership with a Beijing investment bank.

Still, Mr. Cayne's actions amid the turmoil contrast with the hands-on roles of peers such as James Dimon of **J.P. Morgan Chase & Co.**, Richard Fuld Jr. of Lehman Brothers Holdings Inc. and Lloyd Blankfein of Goldman Sachs Group Inc. In August, Messrs. Dimon and Fuld got personally involved in negotiations for new financing terms on the sale of a Home Depot Inc. unit that had lost value amid the squeeze. Mr. Blankfein canceled plans to spend the last two weeks of August at his beach house, missing a chance to spend time with his sons before they headed to college. Through the summer's market gyrations, Mr. Blankfein frequently visited Goldman mortgage desks.

CRISIS MANAGEMENT

- Background: Two Bear Stearns hedge funds faced turmoil in June and July as mortgage securities they held dropped.
- CEO's Oversight: James Cayne took long golfing weekends and spent 10 days at a Tennessee bridge tournament during the crisis.
- Internal Support: Bear officials dismiss any suggestion the 73-year-old CEO might not be fully engaged.

The fund trouble was a shock for Bear, which was known as one of the Street's savviest risk managers. For years the firm relied on a system of "ferrets," or managers who monitored trades, to spot problems. Potential issues were reviewed in weekly meetings, at which Alan "Ace" Greenberg, the 80-year-old executive-committee chairman who led Bear until 1993, was an active participant. Nowadays, say people with knowledge of the gatherings, the firm's risk-review meetings are held more than once a week, and after

years of spotty attendance, Mr. Cayne is a more-regular participant.

The tough-talking Mr. Cayne personifies Bear's aggressiveness. A onetime scrap-iron salesman, he joined Bear in 1969 and rose quickly in the brokerage division, catering to wealthy individuals. He developed a rapport with Mr. Greenberg, who shared his love of bridge, and the two frequently played after hours at the Regency Whist Club in New York. In 1993, Mr. Cayne unseated Mr. Greenberg to become Bear's CEO. Mr. Greenberg referred questions to a Bear spokeswoman.

Over the next 14 years, Bear expanded and its stock price rose nearly 600%. Mr. Cayne made some progress in turning the firm, a trading powerhouse, into more of an investment bank that helps companies with financing and mergers. Colleagues say he has been good at developing young talent, such as Chinese-born Donald Tang, who eventually became a vice chairman and chief of Bear's Asian operations.

Mr. Cayne's management style at Bear headquarters in Manhattan is to strategize in small groups in his

private sixth-floor office, often wielding a lit cigar. He often seeks consensus, after consulting associates. Mr. Cayne is "a great captain" who's made a "tremendous contribution to growing a very significant franchise" over many years, says David Winters, a former chief of mutual-fund firm Franklin Mutual Advisers LLC, long one of Bear's larger institutional shareholders.

For the year 2006, Mr. Cayne took home \$34 million in pay and became the first Wall Street chief to own a company stake worth more than \$1 billion. Although the value of his stake has since fallen, along with Bear's share price, he remains one of the firm's single biggest investors, according to public records.

He has resisted overtures to sell Bear. In 2002, when Mr. Dimon, then head of Bank One Corp., raised the possibility of buying Bear, Mr. Cayne didn't give the idea much consideration, according to people to whom he spoke. Mr. Cayne told members of Bear's executive committee he would do a deal only for a significant stock price premium, a big personal payout and the use of a private jet, say people familiar with the conversation. The takeover idea ultimately faded away.

Mr. Cayne revels in being a Wall Street maverick. He has described his disinclination to travel for business matters, saying privately he wouldn't meet with President Bush about economic issues unless the president came to Bear's New York offices.

He is blunt. Investment-firm chief Alexandra Lebenthal brought her 11-year-old son to visit Bear a few years back. She says she introduced him to Mr. Cayne, who pulled her aside and said, "That kid's got a rotten handshake. He's going nowhere in life." Ms. Lebenthal, chief of a unit of Israel Discount Bank of New York, says she instructed her son on the importance of a firmer handshake.

Mr. Cayne, who has also used bridge to help recruit clients, considers tournaments a welcome break, say people who've spent time with him at the events. He has played in at least three so far this year, staying from a few days to over a week at each.

Attendees say Mr. Cayne has sometimes smoked marijuana at the end of the day during bridge tournaments. He also has used pot in more private settings, according to people who say they witnessed him doing so or participated with him.

After a day of bridge at a Doubletree hotel in Memphis, in 2004, Mr. Cayne invited a fellow player and a woman to smoke pot with him, according to someone who was there, and led the two to a lobby men's room where he intended to light up. The other player declined, says the person who was there, but the woman followed Mr. Cayne inside and shared a joint, to the amusement of a passerby.

Mr. Cayne denied emphatically that such an incident occurred. "There is no chance that it happened," he said. "Zero chance."

Asked more generally whether he smoked pot during bridge tournaments or on other occasions, Mr. Cayne said he would respond only "to a specific allegation," not to general questions.

Bear's travails began early this year with signs of trouble in the mortgage market. Home prices were slipping, while delinquencies on loans to the weakest borrowers, called subprime loans, were up. Late

February brought a swoon in an index that tracks packages of subprime loans that have been sliced up and resold to investors in the form of complex securities.

Two Bear Stearns hedge funds -- investment partnerships for rich people and institutions -- were heavily invested in such securities. The funds used leverage, or borrowed money, to amplify their bets, magnifying both gains and losses. Reflecting their holdings, one fund was called the Bear Stearns High-Grade Structured Credit Strategies Fund. The other had the same name plus the words "Enhanced Leverage." That one had \$638 million in investor cash and at least \$6 billion in borrowed capital. So for every dollar of investor money, it borrowed roughly \$10.

Mr. Cayne showed little sign of concern about the mortgage market at a dinner with analysts in late March, according to one attendee. But soon that market took a turn for the worse. The values of some holdings in both hedge funds sank. The more leveraged fund told its investors in early June that it was down 23% for the year through April, prompting demands by many to get their money back.

To raise cash, both funds began selling billions of dollars of the assets they'd acquired with borrowed money. All this selling put still more pressure on the values of such securities.

About this time, Mr. Cayne began his summertime ritual of taking a helicopter from New York City to Deal, N.J., on Thursdays to make a late-afternoon golf game at the exclusive Hollywood Golf Club, associates say. (He pays for the 17-minute, \$1,700 trips himself, one person says.) After spending the night in his vacation home nearby, associates add, Mr. Cayne generally hits the golf course again Friday morning for another 18 holes, followed by 8 a.m. tee-offs on Saturday and Sunday. Friends say that after his Saturday game, he often heads back to his local home for several hours of online poker and bridge and to play with his grandchildren.

Samuel Molinaro Jr., Bear's chief operating and financial officer, says, "I've never had a problem reaching him."

In the first week of June, the more leveraged fund told investors who wanted out that it couldn't immediately return their money. Wall Street creditors that had lent the fund money reacted sharply to this news, making margin calls, or requests for additional collateral. One creditor, Merrill Lynch & Co., which was owed \$400 million, seized the assets that backed its loan on June 15. Mr. Cayne was on the golf course in New Jersey part of that day, a Friday, having left the office Thursday afternoon, according to a Web site that tracks individuals' golf scores.

Mr. Angelo says Mr. Cayne doesn't carry a cellphone or email device while golfing, in accordance with a policy at the Hollywood club. Mr. Povich says that on Fridays, Mr. Cayne would occasionally use a land line near the course's ninth hole to check in with the office. Associates of Mr. Cayne say top Bear executives often didn't try to contact him between 8 a.m. and 1 p.m. on Fridays, preferring to leave messages with his assistants at Bear to call the office when he was free.

Even when he wasn't there in person, Mr. Cayne was hands-on, say other associates. Mortgage-division head Tom Marano, who temporarily left his post over the summer to help stabilize the two flailing funds in the firm's asset-management division, says Mr. Cayne offered some helpful advice on handling

irascible creditors during a critical period in July. Mr. Marano says the CEO told him in a phone call to "keep your Irish down," or cool his temper and try to negotiate calmly. (Mr. Marano is of Irish and Italian descent.)

Late in June, as the outcry from investors in Bear's hedge funds grew, Bear authorized an 11th-hour loan of up to \$3.2 billion to the less-risky of the two beleaguered funds. The fund ultimately borrowed about half that amount from its parent company.

On July 12, chatting with visitors over lunch, Mr. Cayne seemed less interested in discussing the markets than in talking about a breakfast-cereal allergy and his stash of unlabeled Cuban cigars. On another occasion, he told a visitor he pays \$140 apiece for the cigars, keeping them in a humidor under his desk.

Five days later managers of both funds informed investors their holdings were virtually worthless.

The next day, July 18, Mr. Cayne left for Nashville to play in the bridge tournament, accompanied by his wife, Patricia, who is a neuropsychologist and another avid bridge player. Mr. Cayne took part in a prestigious event called Spingold KO. He was in Nashville all or parts of 10 days, according to bridge and hotel records.

For most of that time, Warren Spector -- then co-president of Bear and also a competitive bridge player -- was in Nashville as well. Mr. Spector was in charge of asset management at Bear, along with all of its trading operations and its prime-brokerage unit, which handles trades for big clients such as hedge funds as well as lending them money.

Amid the hedge-fund crisis, Bear's five-member executive committee gathered almost daily. Mr. Cayne and Mr. Spector dialed in from Nashville in the hours before the afternoon games began.

On the calls, Mr. Cayne rarely dictated orders, participants say. When fingers were pointed, he urged others not to "worry about who got us here."



Warren J. Spector

The funds reached an impasse on July 26. Fretting over a margin call that hadn't been met, Bear took the painful step of seizing most of the remaining collateral in the less-leveraged fund, to which Bear had extended \$1.6 billion in credit. Although the fund had paid back \$300 million of the loan, it couldn't come up with any more cash, essentially forcing its own parent company to shut it down. Days later, Mr. Marano, who had been unable to avert the seizure, initiated bankruptcy proceedings for both funds.

The following day, Mr. Cayne left Nashville to return to New York. By then, new troubles were brewing at Bear Stearns Asset Management, the umbrella division for the two troubled hedge funds. Another, unrelated fund was also facing investor demands for their money back.

Amid the turmoil, Mr. Cayne on Aug. 1 called in Mr. Spector, the co-president who had been with him

at Nashville. Mr. Cayne was annoyed that Mr. Spector had been away from the office during the fund crisis, according to people familiar with his thinking. He told Mr. Spector he had lost Mr. Cayne's confidence and should resign, these people say. Mr. Spector left his boss's office without committing to do so.

On Friday, Aug. 3, with investors in Bear's stock worried about how solid its financing was, executives convened a conference call to reassure people. Mr. Cayne opened it by saying the firm was "taking the situation seriously" and addressing the market issues. He turned over the call to Mr. Molinaro, the CFO. Mr. Molinaro called the bond market's condition "about as bad as I've seen it" in a 22-year career.

An analyst asked Mr. Cayne a question, but there was silence. Mr. Cayne had left, say two people who were with him in a Bear conference room at the start of the call. One says Mr. Cayne had been summoned out by a lawyer advising him on the pending departure of Mr. Spector, who by then was planning to resign. Mr. Cayne later returned, but the hundreds of listeners weren't told this, leaving them with the impression that the CEO had left the call altogether.

As word spread about the call and Mr. Molinaro's grim assessment, the financial markets began to sink. The Dow Jones Industrial Average fell more than 300 points, before recovering slightly to end the day down 2%.

FROM THE ARCHIVES

• [Market Swoons as Bear Stearns Bolsters Finances³](#)
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Later that day, WSJ.com reported the anticipated resignation of Mr. Spector. The co-president, a 49-year-old former mortgage trader, had been seen as a likely heir to Mr. Cayne. The move left Bear with no apparent succession plan, though in a recent interview Bear's lead director, Vincent Tese, said that "the front-runner

is clearly Alan," meaning Mr. Schwartz.

The following day, a Saturday, Mr. Cayne scored a respectable 88 at the Hollywood golf course, according to the golf Web site. But for Bear, things seemed to be falling apart that weekend. Major clients of the firm's prime brokerage division were threatening to pull their business.

Bear executives scrambled to reassure them in phone calls Sunday, Aug. 5, saying that Bear's financing was secure and its risks contained. Yet Bear did lose some prime-brokerage business -- from, among others, Brahman Capital Corp. and a fund connected to Mariner Investment Group, say people familiar with the matter.

Although Mr. Cayne didn't take part in the Aug. 5 calls to clients, according to people familiar with the calls, he spent a rare Sunday at the office leading a hastily called board meeting to accept Mr. Spector's resignation.

Late the Friday of Labor Day weekend, Mr. Cayne flew to Beijing with Mr. Tang, the Chinese-born executive, for a series of meetings that would culminate in a deal.

On Sept. 20, Bear reported earnings for its Aug. 31 quarter: a 61% year-over-year drop -- reflecting an

88% fall in bond revenue and \$200 million in costs linked to the closing of the two hedge funds. Bear shook up its mortgage unit, laying off more than 500 people. It has just laid off 300 more people throughout the firm, though the head count remains at about 15,000.

Bear faces reviews of the hedge-fund collapses by the Securities and Exchange Commission, the Justice Department and Massachusetts state regulators. Bear's board has retained attorney Robert Fiske Jr. to sort out what went wrong. On Oct. 22, Bear and Citic Securities Co., a Chinese investment bank, announced a deal in which each will invest about \$1 billion in the other. In sealing that deal, Mr. Cayne's long-term relationship with the Chinese bank's officials "had gone a long way," says Mr. Tang. Bear's stock edged up on the news but remains down about 30% for the year, the worst performance of any major brokerage firm.

Bear's travails have of late taken a back seat to those of competitors like Merrill Lynch, where a write-down of \$8.4 billion cost chief executive Stan O'Neal his job. Many of Bear's rivals continue to grapple with the fallout of the summer's credit crunch, and when conditions will improve remains unclear.

Friends of Mr. Cayne say he is troubled by the summer's events and concerned about his legacy. "It's one thing if you're 55," says Mr. Angelo, the hedge-fund manager and golf partner. "It's another if you're 73," he says, adding that amid turmoil such as this year's, it can take "periods of time to get your reputation back."

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