INTRODUCTION

Eyewitness to the Crisis

Every weekday I broadcast my show *Closing Bell* from the floor of the New York Stock Exchange. The air inside the NYSE is electric. The pace can be frantic, especially as we approach the ringing of the closing bell at 4:00 p.m. As I watch the traders hunched over their terminals and listen to the dull roar of their voices in the background, I feel a sense of awe. I am standing at the apex of the world's financial system. Everything that happens on the Big Board has consequences for billions of people, and I get to witness it all.

I realized long ago that what takes place at the NYSE is more about humans than about numbers. I know many people's eyes glaze over when they think about the financial system. It feels so abstract and unwieldy. The jargon alone is difficult to master—puts and calls, market makers, derivatives. But in the aftermath of the collapse of Wall Street that occurred in September 2008, people *did* understand that the value of their homes declined precipitously, that their retirement plans bled money, that their jobs were less secure, that their retail customers had disappeared, that business and home loans were no longer available. They saw that because of the

actions of some of America's largest financial firms, their own lives were much less stable and their dreams were on hold.

With these people in mind, I decided to write *The Weekend That Changed Wall Street* in the hope that I could bring an insider's perspective to what happened to those who were directly affected. In particular, those who work outside the financial industry are still demanding explanations. They're confused by the complexity of the financial system, and they want to understand what really happened. Many people have written about the financial collapse, but I believe the position I've been fortunate to have allows me to speak as a true eyewitness, and to translate the complexities of the crisis for the average reader. In this book I will explore what happened behind closed doors and provide an intimate look at the personal stories of those involved—from the richest and most powerful to the average workers. Using my access to scores of the players (famous and not so famous), I will provide the inside story about what really happened during the weekend that changed the financial world I have covered for twenty years. I will show readers how each decision had a drastic impact on the financial system and the personal lives of those involved in it. In addition, throughout the book I will let the participants, observers, and people on the sidelines speak in their own voices—a running oral history of the crisis.

My goal here is to explain these extraordinary events in a way that ordinary people can understand—to ask and answer the questions on everybody's mind. For instance:

- How could the best and brightest in the financial services industry, with their huge compensation packages and ballyhooed brilliance, not see the meltdown coming?

How did so many of these Masters of the Universe become minions of disaster overnight?

- Is any company really too big to fail—and if so, should it be?
- Should the government spend taxpayer dollars to bail out companies whose plights are—at least in part—the result of their own mismanagement?
- Should plain vanilla banking be separated from the riskier securities business?
- Are regulators, who dropped the ball and missed the crisis in the first place, now overreaching in their efforts to "fix" the system?
- What have we learned, if anything, from the crisis? Has "business as usual" returned until the next blowup? Or has Wall Street changed?

In addressing these questions and telling the story of the biggest threat to prosperity since the Great Depression, I will invite you into my world—behind the curtain of capitalism. Knowledge is power, and my intention is to enable readers to get a better grasp of the market and a greater sense of control. It's our country, and we all have a role to play in rebuilding America's economy and making sure that our future is not jeopardized by risk-taking run wild and regulators asleep at the wheel.

PROLOGUE

Riding High Before the Fall

"It's hard to believe it can get any better."

—DAVID RUBENSTEIN, CHAIRMAN OF THE CARLYLE GROUP,
IN AN INTERVIEW WITH MARIA BARTIROMO, JANUARY 2007

DECEMBER 2006

Steve and Christine Schwarzman's annual holiday party was legendary, and normally I wasn't on the guest list. But this year was different. I ended up being invited not because of my professional relationship with Steve, chairman of the Blackstone Group, but because of my connection to his apartment, 740 Park Avenue. The previous owner, Saul Steinberg, is my father-in-law. Saul had purchased the twenty-thousand-square-foot apartment from the estate of John D. Rockefeller in 1971, for well under $300,000, and it had been his home for thirty years. My husband, Jonathan, spent much of his childhood at the Park Avenue apartment, and we held our engagement party there shortly before the sale to the Schwarzmans.

The co-op building, situated on the corner of 71st Street and Park Avenue, is famous for its elite roster of tenants. In 2005 re-

porter Michael Gross wrote a book about it, *740 Park Avenue: The Story of the World's Richest Apartment Building*, in which he detailed its history, dividing the residents into four categories—old money, oil money, new money, and borrowed money. In Gross's view, Schwarzman and Steinberg fell under the final category, men whose wealth was built on Wall Street's massive borrowing power.

In 1999 the Steinbergs put the apartment on the market, and the Schwarzmans swept in, paying more than $30 million—the highest price ever for a Manhattan apartment at that time. Schwarzman was a Wall Street kingmaker, the man people wanted to befriend, and he was eager to demonstrate his place at the pinnacle of power and money by purchasing what was considered to be the best apartment in New York City.

Steve Schwarzman was arguably one of the most important men on Wall Street. Everyone wanted to be close to him, and in a sense everyone deferred to him because he controlled so much of the business. It was a great time to be alive and in private equity. And it was a great time to be Steve Schwarzman.

He was everywhere that year, bullish verging on boastful about the wonders of private equity and, by implication, his own golden touch. When I lunched with him at the Four Seasons restaurant in January 2006, he was ebullient. I asked him, "How easy is it to do a deal today?" and he replied provocatively, "I can do a thirty- to forty-billion-dollar deal in a very short time without covenance." He acknowledged that "in the olden days" a billion-dollar buyout was big news, but we were witnessing a phenomenal uptick in the amount of money flowing into private equity. And he added expansively, "We don't even set up a deal unless we can make at least a twenty percent annual return on investment." Our discussion in

the lunchroom of power was interrupted by a steady flow of table hoppers who wanted to shake Schwarzman's hand and wish him a happy New Year—among them, Sandy Weill, chairman of Citigroup; billionaire investor Ronald Perelman; and real estate kingpin Sam Zell.

Perhaps no one exemplified the stratospheric rise of private equity more than Zell. The sixty-five-year-old billionaire, the son of Jewish immigrants from Poland, was one of the wealthiest men in the world. Crusty, confident, and an unrepentant potty-mouth, Zell was both admired and feared for his ability to play extremely high stakes games. A year after I saw him at the Four Seasons, he would make the deal of the decade, selling Equity Office Properties Trust, a conglomerate of 573 properties, to Schwarzman's Blackstone Group for $39 billion. Blackstone flipped the majority of them, and Zell and Schwarzman walked away with big profits right before the real estate bust sunk most of the properties' values.

In May of 2006, I was a guest host for Charlie Rose. As I sat at Charlie's famous "table" with Schwarzman and David Rubenstein, chairman of the private-equity powerhouse Carlyle Group, I was impressed with how both men oozed confidence and optimism as they talked about making bigger and bigger deals. At one point I said, "You're in the Golden Age of private equity. Do you think the day will come when trees don't grow to the sky and the market shifts away from you?"

"Only foolish people believe that trees grow to the sky," Schwarzman said with a chuckle. "Or young people who haven't experienced trees being cut down. It's important to shine an amber light, to slow down, to not get caught up in the mania."

Indeed, Schwarzman had never been accused of getting caught

up in the mania. He was a smooth operator, even-keeled—"Not a screamer," a colleague once observed. But on that day in May, he was on top of the world, and the trees in his garden did seem to be growing to the sky.

When I saw Schwarzman again in the fall, I casually asked him, "So, how's your apartment? You know, we had our engagement party there. It's an unbelievable place."

He was enthusiastic. "Maria, you've got to come over and see it." And he invited me to his holiday party.

I was interested in going, of course—not just because I was curious about the apartment, but also because I was a business reporter. Schwarzman's guest list was sure to include many of the captains of finance. So I accepted.

I didn't want to attend Schwarzman's party alone, but I also didn't want to put my husband in a tough spot. Did he have lingering sentimental feelings about the apartment? Would it make him feel bad to return there? He assured me it was no problem for him.

When we walked into the apartment it was still breathtaking, but different. Gayfryd Steinberg, a woman of impeccable taste, had remodeled the apartment when she and Saul had lived there, and her work had been, in my opinion, sheer perfection. After the Schwarzmans purchased the Steinberg apartment, Christine had wanted to make it her own. She gutted the place and spent a year on a multimillion-dollar overhaul.

I hadn't realized that the Schwarzman holiday parties were always themed. That year's theme was Bond—as in *James*, not *municipal*. The host was dressed in a snazzy tux, portraying 007 with Christine shimmering at his side in a silver gown. Scantily clad "Bond girls" roamed the party serving drinks and hors d'oeuvres.

There were repeated joking references to "Goldfinger" throughout the evening.

The apartment was crowded with well-known Wall Street faces. John Thain, chief executive of the NYSE, was there, having recently purchased an apartment in the building for a reported $27.5 million. I spotted a smattering of "real" celebrities, and smiled when I saw Paris Hilton holding court, surrounded by an admiring group of investment bankers from Bear Stearns, Lehman Brothers, and Goldman Sachs.

At one point in the evening I found myself in a corner chatting with Jimmy Cayne and Dick Fuld. Cayne, the flamboyant chief executive of Bear Stearns, was enjoying himself, as always, despite the buzz of criticism about his extremely large Christmas bonus of nearly $15 million. Fuld, the head of Lehman Brothers, known to be a lone wolf, hugged the corner, having private conversations and at times looking uncomfortable.

A couple of Bond girls slid over to us, and suddenly a photographer appeared. "Take your picture?" he asked. Fuld jumped up in alarm. "I'm not getting my picture taken with any Bond girls," he barked, and took off. Cayne laughed and shrugged. He didn't mind. Nothing could touch him—or so he thought.

In retrospect, the Bond theme was an interesting commentary on the era. Schwarzman might well have imagined himself as the 007 of Wall Street, smoothly sailing above the troubles that afflicted others. He appeared to enjoy playing the sophisticated man's man; the male ideal; a magnet for power, money, and women for whom danger and intrigue were all in a day's work.

Schwarzman was the envy of his peers, but he and they might have paused to consider that in 2006 the primary characteristic of

James Bond was that he was an anachronism, and those who aspired to walk in his shoes were perhaps headed in the wrong direction.

This wasn't the only high-profile party the Schwarzmans threw during that season. The Bond spectacle was followed on February 14, 2007, by a $3 million sixtieth-birthday bash for Schwarzman at the Armory in New York. Jonathan and I were in attendance there as well. The Valentine's Day birthday party got plenty of media coverage, thanks to its dazzling guest list, which included a roster of New York celebrities—Donald and Melania Trump, Barbara Walters with Vernon Jordan, Tina Brown, former New York governor George Pataki, Charlie Rose, Barry Diller, and Cardinal Egan. In addition, there was the familiar cast of Wall Street regulars—John Thain; Lloyd Blankfein, CEO of Goldman Sachs; Stan O'Neal, CEO of Merrill Lynch; Jimmy Cayne; Sandy Weill, now the former chairman of Citigroup; Jamie Dimon, CEO of JPMorgan Chase; and real estate tycoon Jerry Speyer.

Having just been to the Schwarzman apartment, I noticed right away that the Armory was decorated as a replica of their living room. Everything was absolute perfection, as one would expect of a party with such a hefty price tag. Schwarzman's favorite entertainer, Rod Stewart, performed. (I'm told his fee was $1 million.) Patti LaBelle sang "Happy Birthday." It was yet another lavish, over-the-top celebration of capitalism, paying homage to the new captains of finance. Life was good.

Looking back on those parties I can recall the giddiness in the air, the extravagance, the excess. It is burned in my memory—the sight

of all those incredibly accomplished and wealthy men and women laughing and drinking. It reminded me of prewar Berlin, and called to mind a quip that political adviser James Carville made in the early years of the Clinton administration. "I used to think if there was reincarnation, I wanted to come back as the president or the pope or a .400 baseball hitter," Carville said. "Now I want to come back as the bond market. You can intimidate everybody." That was the mood of 2006, only more profound. The people running the financial industry were puffed up, bullish. It felt as if they owned the world, but it was really the beginning of the end of that world.

"It was a great age of leverage, credit, and debt entitlement," Mohamed El-Erian, CEO of Pimco, the world's largest bond investor, told me later. "People felt entitled to do all sorts of things using debt. You suddenly had a massive innovation that reduced the barriers of entry to credit markets. Wall Street believed that it could build one liquidity factory after another after another after another."

El-Erian noted that the mind-set at that point was that everything was basically stable. It was a "Goldilocks economy"—never too hot or too cold. The aura of stability led to false confidence, which led in turn to excessive leveraging and riskier activity. His take seemed to be accurate. The people whom I interviewed didn't appear to have a care in the world. But Schwarzman's opulence was starting to annoy some of his colleagues in the business. Several of them made comments to me that they wished he would stop throwing parties. Others questioned whether Schwarzman's birthday bash and his company's going public the same year represented the top for the industry.

That winter, I did a report from the World Economic Forum in Davos, Switzerland. I asked a group of very big names in finance

what were the most important issues facing business. In retrospect the answers were mostly way off the mark:

- Tom Russo, vice chairman, Lehman Brothers: "Avian flu: High risk, low probability, but if it should happen, people won't come to work. We are trying to figure out how to run a firm from home."
- Martin Sullivan, CEO, AIG: "The threat of terrorism."
- Victor Chu, chairman, First Eastern Investment Group: "Bird flu. It would impact everything and you can't prepare."
- Sergey Brin, co-founder, Google: "The environment and escalating disasters."

It's striking how much focus was on external calamity, as if terrorism and avian flu were the only forces capable of halting the phenomenal tide of growth and prosperity. The only one of so many I interviewed who said anything about banks being at risk was Deutsche Bank CEO Josef Ackermann. In reply to my question, he said, "Overleveraging in the real estate market." *Bingo!* He got it. (Years later I asked Ackermann how he had been so prescient, and he told me that he would advise anyone who asked him that the two biggest problems to avoid in any successful economy were indebtedness and real estate bubbles. When I asked, "So, did you do anything about it?" he admitted, "We did a little, not a lot," noting how competitive the market was then and how difficult it is to put the brakes on during a boom.)

In January 2007 I conducted another interview with David Rubenstein of the Carlyle Group. "What are your expectations for the year? Can this keep up?" I asked him. Rubenstein answered, "It's hard to believe it can get any better." He said that assuming there was no cataclysmic event like 9/11, he expected 2007 to be another big year.

That prediction, born of what—false optimism, bravado, blindness, deceit?—did not come true. Within weeks of Rubenstein's remark, the gloom was setting in. It was going to be a very long year, and a very long fall to earth. This is the story of that fall.

ONE

Nightmare on Liberty Street

"Because of what he did with Bear Stearns, everybody thought good ol' Hank [Paulson] would be there with the money."

—A FORMER TREASURY DEPARTMENT OFFICIAL,
IN AN INTERVIEW WITH MARIA BARTIROMO

SEPTEMBER 12, 2008

The Federal Reserve Bank of New York rises up from a narrow street in the financial district of Manhattan, a literal fortress of limestone and sandstone whose cavernous subterranean vault houses 25 percent of the world's gold supply. The building is a commanding emblem of the security and size of the American economy, and few people enter its Liberty Street doors without feeling a power surge. When times are flush, they may even have an exhilarated spring to their step, happy to be at the center of prosperity. But the men who streamed out of the line of black cars on Liberty Street in the waning afternoon hours of Friday, September 12, 2008, did so with heads bent, battling gusting winds and a torrential downpour. To a man they were extremely grim. Their names were among Wall

Street's elite—Jamie Dimon, of JPMorgan Chase; Vikram Pandit, of Citigroup; Brady Dougan, of Credit Suisse; John Thain, now of Merrill Lynch; John Mack, of Morgan Stanley; Lloyd Blankfein, of Goldman Sachs; Robert Kelly, of Bank of New York Mellon; and Robert Wolf, of UBS Group. Waiting inside were the horsemen of the apocalypse—or, perhaps, the angels of salvation (no one knew then which it would be)—Treasury secretary Henry "Hank" Paulson, New York Fed president Timothy Geithner, and SEC chairman Christopher Cox. At issue that particular day was the fate of Lehman Brothers, the 158-year-old investment banking firm that formed one of the pillars of Wall Street. The men gathering faced the blunt reality that Lehman could not open for business the following Monday without a rescue—and that rescue was in their hands.

As the titans of capitalism plowed through the rain-drenched streets of lower Manhattan, each was filled with a deep inner turmoil. Several of them would later admit to me how troubled they were. John Mack, CEO of Morgan Stanley, who had earned the nickname "Mack the Knife" for his ruthless, unsentimental ability to slash costs and pursue profits, spoke softly as he recalled the sense of crisis. "The dominoes were falling," he said, "and one of them was almost Morgan Stanley." Every man present was likely feeling the same way—not just concern for Lehman, but dreading his own fate.

The meeting was called for 6:00 p.m., but the bad weather delayed it until nearly 7:00. Rain always means traffic bottlenecks in New York, especially on a Friday night. Mack described the ride down from the Morgan Stanley offices in midtown. "It was pouring, and traffic was stopped. I was worried that we wouldn't get there on time. And my driver, who was an ex-policeman, said, 'Hey, boss, do you see that bike lane over there? Does it go all the way down to the

Battery?' I said, 'Yeah, I think it does.' So we took the bike lane and got there in five minutes. That's how important it seemed."

Hank Paulson and a couple of associates had flown in from Washington, and their car crawled through the clogged streets. While he rode, Paulson worked the phone. For more than a week he had been trying to facilitate a behind-the-scenes deal with Lehman Brothers and one of two promising suitors—Bank of America and the British bank Barclays. It was no secret that BofA was the preferred buyer. Certainly, Lehman CEO Dick Fuld felt that way, and many others shared the view that the company should be kept in American hands. Earlier that day Paulson had taken a call from New York senator Chuck Schumer, expressing concern about the prospect of the Brits buying Lehman. He suggested that a foreign owner wouldn't have the same commitment to jobs as an American firm, and he worried about setting off a firing spree on Wall Street.

Like a manic marriage broker, Paulson had been going back and forth between Fuld and Bank of America's CEO, Ken Lewis. Paulson knew that after JPMorgan acquired Bear Stearns earlier that year, Bank of America was likely the strongest, most deep-pocketed American bank that could pull off another takeover. Lewis was attracted to the idea of buying Lehman, with one big caveat: he wanted to leave behind the toxic assets—that is, those whose value had declined so substantially that they represented a burden on the balance sheet. It was like making an offer to buy a house except for the leaking roof. Paulson stated repeatedly that the federal government was not going to be on the hook for the bad assets. A private-sector solution was required. But Ken Lewis didn't seem to register what Paulson was saying. Now, sitting in his car, Paulson took another call from Lewis.

"Okay, I'll do a deal if you guarantee all the bad assets."

Paulson sighed heavily. "Ken, we can't do that."

"Then I'm out," Lewis said.

Paulson urged him to wait. He told him about the meeting at the Federal Reserve and suggested that perhaps a consortium of banks could get together and take on some of Lehman's toxicity. Lewis agreed to hold off on a decision, but he didn't sound optimistic.

"Do you think he's really serious about buying Lehman?" Paulson's chief of staff, Jim Wilkinson, asked. They were all beginning to have their doubts. Separate conversations were being held with Barclays, just in case. Members of Paulson's staff were constantly on the phone with the British regulators who, like Lewis, were balking at the idea of taking on Lehman's debt. It was going to be a long weekend, and Paulson had no idea going in whether they'd be able to pull off the save.

I remember asking someone from the Treasury that week whether Lehman's toxic assets were so much worse than what anybody else had on the books.

"Oh, yeah," he said. "The difference between Bear and Lehman was that everybody had been into Lehman looking at its books. They knew exactly how bad it was. I was in there with Bank of America, and they were talking about just some of this horrible land. Believe me, it was awful."

Contrary to the way it is portrayed in movies, the floor of the New York Stock Exchange is not consumed by frenzy or populated by unruly, shouting traders. Computers long ago replaced ticker tape, and the scene today is of hundreds of people hunched over their terminals making electronic trades. Even so, a visceral energy pulses through

the vast room. When the opening bell rings each morning at 9:30, no one can predict with any certainty how the market is going to end at 4:00 p.m.—although hundreds of analysts and reporters are dedicated to the job of divining the outcome. I have been reporting from the floor for more than fifteen years. My afternoon show, *Closing Bell*, broadcasts between 3:00 and 5:00 p.m., which is the apex of global trading. And during this particular time, the nervousness was surreal. Every day I would come in not knowing what to expect. We would watch massive gyrations with the Dow, down 500, 600, 700 points on some days and up 500 points on others. Investors were nervous, and the nervousness manifested itself on markets around the world.

Closing Bell focuses on the financial issues everyone is talking about, and during the few days leading up to that "big weekend," the talk was about Lehman Brothers: Would it survive until Monday? How much did it matter to the financial health of Wall Street if Lehman went down? Would the Fed backstop a purchase as it had done with Bear Stearns six months earlier? Were there serious suitors that might rescue Lehman? The experts were generally pessimistic about Lehman, and the flashing board told the tale: the once-great investment firm's stock closed on Friday at a paltry $3 a share, down from a fifty-two-week high of $67.73.

To outsiders, the crisis might have seemed sudden, shocking, unbelievable—a bolt from nowhere. But it had been coming for a long time. A Lehman insider, recalling the months leading up to this fateful moment, told me, "By Friday, September 12, we just wanted to get through the damn day. Every day you'd sit there and think 'I can't wait until the market closes.' People were transfixed by the ticker and what was happening to our stock price." Now months of agony and hope were coming to a final reckoning, and the ac-

tions of the men gathering at the Fed would define the financial landscape for years and even decades to come.

By the time I arrived at the New York Stock Exchange for *Closing Bell* on Friday, I had been working the phones and text messaging for hours. Lehman Brothers was on the ropes. With the announcement of third-quarter losses of nearly $4 billion, credit agencies were threatening a downgrade unless Lehman raised substantial cash before the weekend was out. Share prices had plummeted throughout the week. Rumors had been floating around for weeks that the state-owned Korea Development Bank (KDB) was talking about acquiring Lehman and/or taking a sizable stake, but that deal was dead by the weekend. My sources told me that the Koreans had made an offer of capital in exchange for a 50 percent stake, but Fuld declined it. "It's not enough," he told them, asking for much more than they wanted to pay. He overreached and lost the deal.

Midway through my show, my BlackBerry started buzzing with the news that Tim Geithner had called a major-league powwow for later that evening, and the principals of the big firms were heading down to the Federal Reserve.

Not everyone knew the exact reason for the summons, but when Geithner called, they responded. The head of the New York Federal Reserve had that power.

"Tell me what's happening," I said to one of my sources. He laughed. "Let's put it this way," he said. "The call from Geithner wasn't a request. He didn't say 'Would you mind coming down?' It was more like an order."

"Is it about Lehman?" I asked.

"I think so," he replied. "I think they're going to try and get a

pound of flesh from us." He said he expected Geithner and Paulson to pressure the firms to ante up some hard cash to save Lehman.

Moments later, I was back on air, fielding a series of commentators, some of them alarmists, lining up for an anticipated weekend bloodbath around Lehman Brothers. By now it had become somewhat commonplace to wait for the weekend meetings to get news before the opening of the Asian markets on Sunday. This weekend felt the same, but it was actually more significant. "The world changed very quickly and caught the U.S. financial system off guard," Mohamed El-Erian told me, adding, "When we look back we're going to say, 'Wow! That was a period when the U.S. financial system was redefined.'"

With Lehman shares at rock bottom as we neared the close, everyone was speculating about what price Lehman might command, and whether there were any viable suitors. There was broad agreement that Lehman was *not* too big to fail. "They have their hat in their hand at this point," said David Kelly of JPMorgan. Harvard University professor Martin Feldstein agreed that Lehman was no Bear Stearns and probably did not warrant a government backstop. "There is no reason why the shareholders or, indeed, the creditors of Lehman should be protected if in fact there isn't enough capital there for Lehman to be viable," he said. Feldstein was joining a growing chorus of financial experts who believed the system had reached a dangerous tipping point of too much government involvement, brought about by an overleveraged system. But there was still debate about whether the firm would, in fact, be forced to declare bankruptcy.

Jerry Webman, chief economist at Oppenheimer Funds, voiced deep concern. "This is a sea change in the financial world," he said on my show that day. "For twenty-five years we've had an economy based on financial leverage—earnings based on the ability to borrow

and put borrowing on top of borrowing, easy money driving these economies, driving earnings forward. What we're trying to do right now is sort out who's got a good long-term earnings model from solid business and whose balance sheet is potentially a lot of air."

Most people I spoke with said to me, "Maria, this is different. This is unbelievable. This is the worst thing I've ever seen." And it wasn't just the specter of a bunch of wealthy Wall Streeters being toppled. Unlike Bear Stearns, where stock in the company was mostly held by the top executives, Lehman had a trickle-down ownership culture, with the lower rungs of the company, such as executive assistants, paid in stock. If Lehman fell, there would be a lot of average people left with nothing.

As the business day drew to a close, CNBC showed scenes of Lehman employees leaving the building, saying that they didn't know if they would be back Monday. There were many tear-streaked faces outside Lehman headquarters in Times Square that day. Even so, few people, including the principals, believed Lehman would go down. For those on the outside, it was simply inconceivable.

The three men on the hot seat this weekend—Tim Geithner, Hank Paulson, and Chris Cox—were by no means a cookie-cutter team of financial types. That is to say, these were bright and very different men who shared one big commonality: the desire to get something important accomplished, popularity be damned. There are few times in life when one's actions may create history, and they all knew that this was one of them.

New York Fed president Tim Geithner took a lot of ribbing for his youthfulness. The first time people met the slender forty-seven-

year-old, they often remarked that he looked too green to bear such a large responsibility. The word most often used to describe him was "boyish." But Geithner's résumé was impressive. Born in New York City, the second-generation offspring of German immigrants, Geithner spent most of his childhood living abroad and graduated from Dartmouth with a degree in Asian studies.

One thing that distinguished Geithner was that he wasn't a product of Wall Street. His rabbi was former Treasury secretary Robert Rubin, who years earlier told me, "Geithner will one day be Treasury secretary." When he was tapped for the Fed position in 2003, Geithner was working at the Council on Foreign Relations, and, indeed, he'd spent his entire career in government and quasi-government positions. He didn't come from the culture of the Street, where success was often measured in sizable bonuses and fat stock portfolios. He and his wife and two children lived in a modest house in Westchester County and were not regulars on the New York social scene. (Later, when Geithner was named Treasury secretary by Barack Obama, he had a tough time selling his house, even after he'd slashed the price to under $1 million. He eventually rented it while he waited for the real estate market to turn around.)

Geithner's low-key, no-drama style was well suited to his position. But no one ever accused Geithner of being a pushover.

In a crisis, Geithner made a good partner for Paulson, who was known to be emotional and passionate. In office just under two years, Paulson brought almost a religious fervor to his job; he felt he was there for a purpose.

Unlike Geithner, Paulson was the epitome of a Wall Street man. Before President Bush nominated him for the Treasury, he was the chairman and CEO of Goldman Sachs, a firm he had joined back in 1974.

A Christian Scientist and a family man, he was a quiet, though influential, player in corporate America long before becoming secretary.

Paulson's job, arriving at the Fed, was to convince the CEOs that the solution was up to them. "Everyone thought good ol' Hank would be there with the money as he was with Bear Stearns," a source at the Treasury told me. "And they weren't going to believe otherwise until Hank told them in person."

In truth, the federal government did not have the authority to lend money to failing institutions, only to institutions that were solvent. The reason a Bear Stearns backstop had been possible in March was because a highly solvent institution, JPMorgan, took over. The Fed could not have loaned money to Bear Stearns directly, but it was able to do so with JPMorgan's help. Paulson was essentially paving the way for a similar setup with Lehman Brothers and a solvent savior such as Bank of America or Barclays—with one difference. He wanted the backstop to come from the private sector.

The third man on the team, Christopher Cox, was the "grim reaper." His primary task was to shepherd Lehman Brothers through a bankruptcy proceeding, if that was to become necessary. At fifty-five, Cox had worn many hats in his career, including a stint at the Reagan White House and seventeen years as a California congressman. The accomplishments of his professional life were set against the backdrop of remarkable personal crises that underscored his ability to make a comeback. In 1978 he was paralyzed from the waist down in an off-road Jeep accident. He eventually regained the use of his legs, though he was often in pain, even thirty years later. Then, shortly after he became SEC chairman, Cox was diagnosed with cancer. He battled the illness while maintaining a heavy work schedule, and by 2008 was deemed fully recovered.

But while there was much to admire about Cox personally, a chorus of criticism followed him throughout 2008. As the government's primary watchdog, the SEC looked ineffectual in its failure to spot the looming crisis and prevent it. As he joined Geithner and Paulson at the Federal Reserve, Cox had to know his reputation was on the line.

The CEOs were sitting around a long table in the conference room on the first floor when Paulson, Geithner, and Cox walked in. The mood was restless and uncertain. These men were not accustomed to collaborating, and while the call to do so was not completely unprecedented, it wasn't something you'd see in other industries. Imagine, for example, General Motors and Ford being pressured to save Chrysler, or NBC and Fox forking over the funds to save CBS. It just wouldn't happen. But the financial industry was more interrelated. One drowning company could sink them all. Faced with that reality, they had to put aside their modus operandi—to try to kill one another—and start to work together.

Ironically, the last time the Wall Street companies had been called upon to rescue one of their own, Lehman Brothers had been deeply involved as well. It was 1998. Robert Rubin was Treasury secretary, William McDonough was New York Fed president, and Dick Fuld was four years into his tenure as Lehman CEO. A giant hedge fund called Long-Term Capital Management was on the brink of collapse, having lost $4.6 billion in the space of a few months. Since most of the Wall Street firms had ties to Long-Term Capital, the Federal Reserve feared that a failure would have a traumatic ripple effect. In particular, Lehman was vulnerable. The Wall Street firms got together in a consortium and put

their money on the table. Several firms pledged $300 million each, including Barclays, Chase, Goldman Sachs, Merrill Lynch, Morgan Stanley, and JPMorgan. Fuld pledged $100 million on behalf of Lehman, saying he couldn't afford to do more. Long-Term Capital Management was saved, and Fuld got a lot of credit within his own company for bringing Lehman back from the brink. Notably, Jimmy Cayne at Bear Stearns refused to give any money, irking his colleagues.

Geithner opened the meeting. In his quiet, unemotional voice he laid out a gloom-and-doom scenario of what a Lehman fall might mean for the rest of them. Paulson spoke second, telling the men flat out that he didn't have the legal authority to save Lehman. That was up to the people around the table. Initially, there was push back. Wasn't there something the feds could do, without having to rely on the banks for a rescue? But very soon these men, who were top professionals, pivoted and said, "Okay, how can we manage this?" They had all done deals with Hank Paulson in the past, and one thing they knew about him was that when he said "We're not bailing Lehman out" he meant it. Paulson never showed his gun without using it.

Chris Cox spoke last, describing how the SEC would manage a bankruptcy, if one were to happen. No one wanted to go there, but it was Cox's job to take them if necessary.

Although all the news and theorizing were about Lehman, Fuld was nowhere to be seen. He wasn't invited to the Fed because the discussions were about him and his firm. But that didn't mean there wasn't a lot of speculation about what he was up to. Moody, passionate, and proprietary about his company, Fuld was fully engaged on the thirty-first floor of the Lehman Brothers building at the top of Times Square. His lieutenants were at his side, trying to work every last-minute angle. Those close to Fuld said that he believed

with all his heart that if things turned bad they could orchestrate a deal similar to that of Bear Stearns. It never occurred to anyone, least of all Fuld, that the government would not be there to catch Lehman if it fell. An aura of denial filled Lehman's executive suite in the period leading up to the end.

Behind the drama being played out on Liberty Street and in midtown Manhattan was a fact few people realized. There was some personal animosity between Paulson and Fuld, based on their different backgrounds and temperaments. Paulson was a lifetime investment banker; Fuld was a lifetime commercial paper trader. A source told me of a dinner between the two men in the spring of 2008. "A lot of people in the press thought it was a warm and fuzzy dinner," he said. "But it was actually very intense. At one point Dick Fuld lectured Hank Paulson, saying, 'I've been in my seat a lot longer than you've been in yours. Don't tell me how to do my job.'" How ironic that a few months later, Fuld would be so reliant on Paulson's good graces.

Even before it reached full-crisis mode, Lehman had developed a credibility problem, and everyone in the room knew it. I, too, had been hearing the whispers for months. Larry McDonald, who was a vice president and a trader at the firm until 2008, did not mince words when he spoke to me of his former company; no question that as a "worker bee" at the firm, McDonald had an ax to grind. He had become one of the harshest critics of Lehman's culture, even writing a book about it in 2009—*A Colossal Failure of Common Sense*. His view was not unbiased, but it did show how embattled many people down the ranks were feeling at Lehman during that period.

"There was a disconnect between the men in the ivory tower and the wonderful people who worked at the firm," he told me. "Lehman Brothers, to me, was never rotten at the core. That's where

all the beauty was. It was rotten at the head. There was so much talent in the middle that tried to stop the madness. One by one, those who spoke up were silenced. At Lehman, you kept your head down and you did your job, or you lost both."

McDonald painted a picture of a fiefdom where those in the royal suites were more interested in the aura of their personal wealth than the health of the company, and he said that this was especially true at the seat of power—the thirty-first floor of the Lehman building. "The thirty-first floor is one of the most mysterious places on earth," McDonald confided to me. "Some people claim it resembles a Sotheby's art collection facility—or a cross between that and a human resources pom-pom bonfire festival. You had people up there who were totally distanced from the trading floor, very concerned about their new memberships in the billionaires' club—or I should say the $200 billion art club." (In fairness, the space, including the art collection, was not unlike those of most Wall Street firms, but if viewed through a prism of disappointment and resentment, the lavish atmosphere might grate.)

McDonald claimed that Fuld took his eye off the ball years before the collapse, while many in the lower echelons of the company were issuing dire warnings. "As early as 2006, some of the most talented people at Lehman wanted us out of the subprime mortgage business," he said. "We started seeing weird things happening—such as people missing their *first* mortgage payments. That was unprecedented. There was something wrong. It was like a slow-motion car wreck."

Certainly, Fuld had his defenders at the firm. "To say Dick was not engaged is nonsense," one of them told me. "Leading up to mid-September, he was working around the clock to save the firm. And he was getting absolutely no help from the SEC in dealing with the

shorts and the rumors, or from other banks. Look at JPMorgan. They were the bank that facilitated Lehman's trades. There's a clause in the contract that basically gives them the right to ask for however much collateral they want. So they just started grabbing more and more and more collateral. And it was devastating."

Robert Diamond was not a particularly emotional guy. His long face was pleasant but inscrutable. The president of British-owned Barclays Capital was known to be a cagey player, with the placid air common to members of large families. One of seven children, Diamond grew up in Concord, Massachusetts. Both of his parents were schoolteachers. Although Barclays was Britain's premiere bank, Diamond retained an abiding love and loyalty for the home teams—the New England Patriots and the Boston Red Sox. He was, beneath the British flag, a quintessential Wall Street guy, who had cut his teeth at Morgan Stanley and had joined Barclays only after being passed over for the top job there.

On Friday, September 12, Diamond's normally calm demeanor was shaken by the weight of phenomenal responsibility. He felt uncommonly emotional as he sat in a room on the fourth floor of the Federal Reserve, away from the main conference room where the CEOs were gathered. Diamond thought that he, in particular, was on the line because many people were looking to his company to rescue Lehman, and he just didn't know if it could be done.

For more than a year Barclays had been actively pursuing growth in the United States, looking for the right vehicle. After the Bear Stearns fire sale, it occurred to Diamond that perhaps it could be the template for a deal, and the firm that came to mind was Leh-

man Brothers. He thought, "What an incredible opportunity." He salivated thinking about Lehman's thirty-two-story building and its ten thousand New York employees. But he wanted a distress price, and he wanted a government backstop—just like Jamie Dimon of JPMorgan got for Bear Stearns earlier in the year.

Diamond had many unofficial conversations with Hank Paulson and his people as the summer stretched into fall. These were "what if" discussions as Diamond felt his way on matters of procedure and price. In the days before the final weekend, the discussions intensified. Thursday, September 11, a team from Barclays had begun doing their due diligence, taking apart Lehman's books, and they would continue, sleepless, throughout the weekend.

"It was clear to us that this was a fantastic franchise," Diamond recalled to me. "The scope of its business was impressive and many were operating very well." But the drawbacks were just as striking, and they all boiled down to one reality: Lehman had no liquidity.

Now Diamond was feeling the stress. He was not a poker player, and this was a beads-of-sweat-inducing moment. "It was stressful. It was emotional," he told me later. "We realized we were playing for big stakes. So, on one hand, we knew that if Lehman went into bankruptcy, there would be huge implications in the market. On the other hand, we wanted to look at whether or not there was a transaction that made sense for Barclays, as well as for the markets."

The problem: Hank Paulson's insistence that there would be no federal backstop, no bailout, no sweet Bear-style deal. Bob Diamond wanted Lehman. But could it happen? Would his own regulator, Britain's Financial Services Authority, allow a sale?

John Thain had been riding high for some time. His career was on a fast track. He was savvy and cerebral, with a square jaw and a bland demeanor, and a résumé that was rock solid. Thain had been president and co-chief operating officer at Goldman Sachs before becoming CEO of the New York Stock Exchange. He had held the top job at Merrill Lynch for only nine months. When he was brought in to replace the retiring chief executive, Stan O'Neal, everyone on Wall Street had been surprised. The scuttlebutt was that Thain would be tapped to replace Chuck Prince at Citigroup and that Larry Fink of BlackRock would take over Merrill. But I was told that Fink would not entertain the idea unless he was allowed to review Merrill's balance sheet and accounting, a reasonable request that the board denied. So Thain was the choice. He was hired to strengthen a rudderless company, as he told me in November 2007 when he started his new job. "The board is looking for leadership," he said. "The board is looking for strategy and direction. The board is looking to unify the company."

From the outset Thain was aggressive in his efforts to strengthen Merrill. His first task was to get rid of the bad assets on Merrill's books. He brought in highly paid, talented executives—many of them former colleagues from Goldman Sachs. Among them was a top examiner whom he paid $40 million to clean up the books. Hearing about the exorbitant number, I asked Thain, "Is it true? How do you justify bringing this guy over and paying him so much?" Thain defended the idea. "That's right," he said. "I'm going to pay him. He's a talented guy, and I am going to pay top dollar to ensure this never happens again." It was a huge payday for the examiner, who wound up staying three months.

Now, sitting at the Fed, Thain listened carefully to what was being said. For Thain and his colleagues it was glaringly apparent that much

more was at stake than just the future of Lehman Brothers. This was a massive wake-up call, a thump on the head to all the Wall Street firms. It was no longer about one firm failing—be it Bear Stearns or Lehman—it was about the tangled interconnectivity. The major Wall Street firms were like climbers roped together on an icy slope. Earlier that day, Merrill's board of directors had a conference call with Thain expressing concerns that the short-sellers would be coming after Merrill next. No one was immune. "I'd better figure out how to protect Merrill," he thought, "or we could be next." Although Thain had assured his board that Merrill was no Lehman, he could envision a similar downward spiral occurring, especially if the short-sellers set their sights on his firm, creating a run on the bank.

Paulson and Geithner were pushing the top firms to share the burden. Politically, Paulson didn't think he could save another Wall Street firm. There was too much pressure, especially from Republicans in Washington, to not bail out anybody else. He wanted the rescue, if there were to be one, to come from Lehman's counterparts.

"We have to figure out what needs to be done here," Paulson told them. He outlined the options, including potential mergers. Lloyd Blankfein, CEO of Goldman Sachs, thought things were moving a little too fast. "All right," he said, preparing to leave, "let me think about this and I'll get back to you. I have to speak to my board."

"Yeah, you can think about it," Paulson replied, pointing in the direction of meeting rooms down the hall. "Take a room. We're going to fix it this weekend. You're not going anywhere. If you need to talk to your boards and bosses, you'll have privacy. But we're doing it this weekend, before the Asian markets open Sunday night."

Morgan Stanley's John Mack sat gloomily at the table, feeling that the March sale of Bear Stearns had been a dress rehearsal for

the big show that was now happening before him. He had spoken to Dick Fuld on several occasions in recent months, trying to figure out if there were things that could be done—assets that could be purchased, even a merger. But nothing was clicking. "You had this sense," he told me later, "that we were all tracked for some change, especially Lehman. What that meeting brought to the forefront was the reality of it and the impact of it. I don't think we fully understood until then how bad it really was. The question was, how did you contain this contagion? Could you build a buffer that stopped with Lehman?"

Mack contemplated the possibility that the markets really could melt down. He didn't feel scared, but the determination was growing in him, and he could see it in others around the table. They *had* to fix this problem.

Robert Wolf, chairman and CEO of UBS Group, had received the call from Geithner's office at 3:30, saying, "Please come down. There's going to be a meeting." He replied, "Can you tell me what this is in reference to?" The person on the line wasn't too forthcoming except to say, "If you need to invite someone, I'd recommend bringing your chief risk officer."

Wolf chuckled, remembering the call. "Obviously, some people were more in the loop than I was, because they'd been engaged earlier by the Fed or by Lehman."

Citigroup CEO Vikram Pandit was not entirely clear why he had been summoned to the Federal Reserve, but he could feel the buzzing sense of urgency as soon as he arrived. Pandit had joined Citi in 2007 when it acquired his hedge fund, Old Lane Partners, for $800 million, and almost immediately got bumped up to the top position after Chuck Prince was forced to resign. Now, sitting across the table from

Paulson and Geithner, surrounded by his peers, he sensed the dread in the room. This wasn't just about one company, he realized.

Prior to that day, there had been a lot of argument over possible solutions—government assistance, buyouts, and mergers. But on Friday, September 12, it sank in that a Lehman bankruptcy would have ripple effects, and the key players realized they needed to stop bickering and try to figure out answers.

One observer painted a remarkable picture for me of powerful opponents working together. "I looked at Jamie Dimon sitting across from Lloyd Blankfein, and I thought I'd love to write a book called *Lloyd Blankfein vs. Jamie Dimon*," he said. "Those two were the giants in the room, and they hated each other so much it was impossible to believe they were sitting there. But you know what? They were very good, very willing to cooperate. And through the whole process I thought Jamie Dimon came off looking better than anybody. He was the guy that always rose above the pettiness with common sense and good ideas." He was also the one who probably knew more than the others, being the healthiest bank at the table. No surprise later when his competitors railed at him for turning up the screws and demanding more collateral just when it hurt the most.

The men at the Fed working on the Lehman crisis had been divided into three groups. The first group was tasked with examining Lehman's financials and determining how much capital would be needed. The second group was assigned to figure out a rescue structure. And the third group was assigned to figure out what would happen if Lehman could not be saved. "You've got to try harder," Geithner warned them, his temper frayed. They seethed—no one appreciated being lectured to by Geithner. But they went off to their groups to get started.