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Former CEO of Bear Stearns, James Cayne Written Testimony Before the FCIC

James E. Cayne

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Before the Financial Crisis Inquiry Commission

May 5, 2010

Chairman Angelides, Vice-Chairman Thomas, and Members of the Commission, my name is James E. Cayne. I was the CEO of Bear Stearns from 1993 until January 8, 2008, and I remained non-executive Chairman until the firm was acquired by JPMorgan Chase & Co. in June 2008. I appreciate the invitation to appear before you today.

Bear Stearns was a remarkable company and I am proud to have spent my career there. I joined the firm in 1969, when it was a partnership with about thirty partners, and I worked there for almost forty years. Even after it became a public company, a large part of the firm—about one-third—was owned by its employees. To align the long-term interests of employees and shareholders, a significant part of its senior employees' compensation (typically around one-half or more for the most senior members of management) consisted of restricted stock units and stock options. Like many employees I rarely sold a share of the firm's stock except as needed to pay my taxes.

Bear Stearns had a strong culture of risk management. The head of the firm's risk management reported to the firm's Executive Committee. My office door was always open to any employee who had concerns about violations of our risk or compliance policies, or any other inappropriate conduct.

Beginning in early 2007, the market for subprime mortgages and securities backed by those mortgages began to experience severe dislocations. Although Bear Stearns had limited involvement in the subprime sector, the subprime crisis resulted in losses in two hedge funds managed by Bear Stearns Asset Management, a wholly-owned subsidiary of Bear Stearns. Although we attempted to preserve the stronger of the two funds by extending $1.6 billion in secured financing to that fund, both funds ultimately failed.

I do not believe that the collapse of these funds was a significant cause of the later collapse of Bear Stearns itself. While Bear Stearns took some of the funds' assets onto its balance sheet in connection with the funds' bankruptcies, those assets represented less than one-half of one percent of the firm's total assets.

Over the course of 2007, the market for subprime and, increasingly, other mortgages continued to decline. In view of Bear Stearns' leading role in the mortgage industry, these developments gave rise to market uncertainty about the firm.

We believed that this concern was unjustified and that the firm had ample capital and liquidity. Nevertheless, we worked aggressively to address the market's concerns. During the fall of 2007, the firm raised an additional $2.5 billion in long term debt. We also entered into an agreement in principle for a joint venture with a major Chinese securities firm that would have increased Bear Stearns' marketing strength in Asia.

As I mentioned, I stepped down as CEO in early January 2008, and was not involved in the day-to-day management of the firm following my departure. Nevertheless, I would like to offer my opinions about the reasons for Bear Stearns' collapse.

Despite the efforts we made prior to 2007 to reduce our exposure to the subprime sector, the scale of our activities in other sectors of the mortgage market caused widespread concerns about Bear Stearns' solvency. These concerns were unfounded. Our capital ratios and liquidity pool remained high by historical standards. Nevertheless, as a result of these rumors, during the week of March 10, 2008, brokerage customers withdrew assets and counterparties refused to roll over repo facilities. These events resulted in a dramatic loss of liquidity. The market's loss of confidence, even though it was unjustified and irrational, became a self-fulfilling prophecy.

Subsequent events show that Bear Stearns' collapse was not the result of any actions or decisions unique to Bear Stearns. Instead, it was due to overwhelming market forces that Bear Stearns, as the smallest of the independent investment banks, could not resist. Only a few months after Bear Stearns collapsed, the same market forces caused the collapse and near-collapse of much larger institutions, such as Lehman Brothers. The efforts we made to strengthen the firm were reasonable and prudent, although in hindsight they proved inadequate. Considering the severity and unprecedented nature of the turmoil in the market, I do not believe there were any reasonable steps we could have taken, short of selling the firm, to prevent the collapse that ultimately occurred.

I look forward to answering your questions.