



Inside the Bunker: CEO John Mack on Saving Morgan Stanley

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During the depths of the global financial meltdown in September 2008, John Mack faced the most critical moment of his tenure as CEO of Morgan Stanley. The investment bank was nearly out of cash, its stock price plunging into the single digits as investors lost all confidence in the financial sector. Mack was under enormous pressure from U.S. Treasury Secretary Timothy Geithner -- who was then head of the New York Federal Reserve Bank -- and from Geithner's higher-ups, then-Treasury Secretary Henry Paulson and Fed chairman Ben Bernanke. Their suggestion: Save the bank by merging with another player, most likely JPMorgan Chase & Co., for a price as low as a dollar.



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But Mack, who related this story during a recent Wharton Leadership Lecture, was pursuing a very different strategy, aimed at saving Morgan Stanley with the dual goals of preserving thousands of jobs as well as one of the best-known names on Wall Street. Central to that plan was an influx of cash from outside investors, but Mack's effort to negotiate such a deal on a Sunday afternoon with Japan's leading bank -- Mitsubishi UFJ Financial Group -- kept getting interrupted by phone calls from Geithner and Paulson, begging him to call JPMorgan Chase's CEO, Jamie Dimon.

After the second interruption, this time from Paulson, Mack recalled that he was already at the end of his rope. "I'm on the phone for three or four more minutes and [my assistant] comes back and says, 'Tim Geithner is on the phone and he wants to talk to you *now!*'" Mack said he responded instantly: "Tell Tim Geithner to get [bleep]."

The rest is financial history. Mack stayed on the phone as Mitsubishi agreed to invest up to \$8.4 billion in Morgan Stanley -- the largest overseas investment by a Japanese financial firm ever -- and then he worked out a deal with regulators to convert the investment bank into a bank holding company, a move that offered much greater flexibility for dealing with the fast-moving crisis. Little more than a year later, the new Morgan Stanley is on solid ground with a focus on its brokerage business after purchasing that unit from Salomon Smith Barney. Mack is planning to leave the post of CEO at the end of the year, although he will stay on as board chairman.

Mack said that his primary motivation from the beginning of the crisis was to keep Morgan Stanley intact. He recounted what he had told Paulson, Bernanke and Geithner in their first phone call earlier on that decisive Sunday: "Let me ask a question of the three of you. I have 45,000 employees. In New York City, you have AIG, Lehman Brothers, Bear Stearns, Merrill Lynch and the other layoffs -- probably 45,000 jobs that *they* lost. From a public-policy standpoint, does [merging Morgan Stanley with JPMorgan Chase] make sense?"

Separating Fact from Fiction

While Mack's hour-long talk was heavily sprinkled with tales of high and mighty intrigue inside and outside of government, he said his main lesson on leadership from the 2008 financial crisis was the need to keep employees -- both executives and the rank-and-file -- fully informed on the situation and to let them know that their concerns were the company's first priority.

"We had a number of town hall meetings and I tried to say to people, 'Here's what's going on, here are the facts you need to know -- what's rumor and not rumor,'" Mack noted. "When I had our first meeting, when our stock was getting crushed after the earnings report, I led off with: 'If you want to sell your stock, sell

-- we're not keeping notes on who sells and who doesn't. You need to be comfortable with your situation."

If the audience came to hear Mack tell about growing up as a child of Lebanese immigrants in North Carolina, his odyssey through the upper ranks of Morgan Stanley, his brief time away running two other top financial firms before returning as Morgan Stanley's CEO in 2005, or why the white-shoe firm moved toward the brink of extinction, then they were in the wrong auditorium. Mack knew that he had the war story of a lifetime from inside the bunker of the 2008 financial crisis, and he was determined to tell it. Indeed, he said he felt liberated to reveal insider details because most of it was about to be published in a book by *New York Times* reporter Andrew Ross Sorkin. (After relating his profane reaction to Geithner, Mack paused, shrugged and said, "It's in the book" -- drawing a huge laugh.)

Morgan Stanley, like other Wall Street banks, was heavily leveraged with investments in mortgage-backed securities and other high-risk investments. By September 2008, the firm -- which was created in 1933 when the Depression-era Glass-Steagall Act forced the breakup of the original J.P. Morgan & Co. -- had written down some \$15.7 billion in bad loans and investments.

But the real trigger for the worldwide crisis was the collapse of rival Lehman Brothers. On Friday, September 12, 2008, Mack received a call from Geithner asking him to join other top financial executives in an emergency meeting in lower Manhattan to discuss Lehman's impending collapse. His limo was stuck in gridlock -- until Mack ordered his driver to take the bike lane. "We actually got there in five minutes -- it was amazing how fast," Mack recalled. "A couple of bikers threw things at us."

But when Mack got there, he and the other private banking leaders balked at what the Treasury Department was asking them to do: create a "bad bank" to park the so-called toxic assets of Lehman Brothers. "It was clear that Secretary Paulson did not have the political capital to go to Washington after [the bailouts of] Freddie and Fannie and Bear Stearns and get more money -- so he was asking the Street to help out. The conversation around the table was basically, 'Look, Hank, if we do this, what are you going to do when AIG gets into trouble?'"

But Lehman's bankruptcy, announced that Sunday night, September 14, sent global markets into a downward spiral and destroyed investor confidence in financial firms, including Morgan Stanley. "We went into that week with \$181 billion in cash -- not in securities, not in Treasuries, not in IBM stock, but in cash -- because we knew there would be a run on the bank," Mack noted. But on the first day of trading after the Lehman collapse, Morgan Stanley stock lost roughly 30% of its value.

Ironically, Morgan Stanley was still very profitable. In fact, Mack and other top executives decided to move up the company's healthy quarterly earnings report by a day, to that Tuesday afternoon -- but there was virtually no positive impact when they did.

"The whole game was to hold on, to find other sources of capital," Mack recalled. So Morgan Stanley went to the only people who had the wherewithal to do that, including high-level Chinese bankers and officials as well as the Mitsubishi Group in Japan. At one point, the bank even reached out to U.S. billionaire Warren Buffett. Mack also had conversations with leading Wall Street bankers, and he snapped at JPMorgan Chase's Dimon when he felt the CEO was going behind his back and talking to underlings.

"If we're going to do business, we need to be direct," Mack said he told Dimon in a heated conversation. "I don't want you going around me.' But if it was an information-gathering exercise, I don't blame him for it. I might have done the same thing."

Jokes and Blood Pressure Monitors

At the depth of the crisis, Mack said that he tried to convey an aura of confidence and break up the considerable tension with humor. "All I know is, the one thing I could not do is let my team see how concerned I was -- and I don't think they ever did. I tried -- oftentimes -- to make light of what was going on."

Mack kept a blood-pressure device on his desk that he and his executives used for a laugh at critical times (although he added that one executive was actually sent to the hospital for stress because his level was so high). When a colleague spoke of his annoyance over family members who ate in front of him as he fasted for a Jewish holiday that week, Mack sent a pizza to his house every hour for seven hours straight. "He

[told me] the housekeeper really liked it."

According to Mack, the pep talks, town meetings and jokes were critical to seeing his firm through the crisis. His emphasis on employees was at the core of his mounting dispute with Paulson, Geithner and Bernanke, he added. "I disagreed with them -- but I'm not upset with them. Their job is to have financial stability, while my job is to protect the firm and keep it going. It wasn't nefarious, it wasn't mean -- it was just practical. They did a superb job."

In the end, Mack said, he told them: "I have the utmost respect for the three of you -- what you do for this country makes you patriots. But I have 45,000 employees. I won't do it," referring to the \$1 JPMorgan Chase offer. "I'll take the firm down" -- and he hung up the phone.

A year later, Morgan Stanley is alive and doing well. On January 1, the now-64-year-old Mack will hand over the CEO duties to current co-president James Gorman. Although he didn't discuss his vision for the salvaged company's future, he noted that the financial sector in general is taking great strides to reduce its amount of leverage -- a critical factor in the 2008 collapse -- and place greater emphasis on risk management. Compensation on Wall Street "[spun] out of control" in order to prevent top talent from leaving to work for hedge funds beginning in the 1990s, he added, and there should be greater emphasis on long-term success, using company stock for compensation, and possibly "clawback" provisions that would reduce bonuses for poor performance.

But Mack still believes in the markets. "I own gold, I own index TIPS to inflation, I own a certain integrated oil company and master limited partnerships in oil and gas ... and of course I own Morgan Stanley stock," he noted in response to an audience member's question. "There will be another crisis," he added later on. "It won't be in my lifetime."

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