10-1-2007

SEC Email from Robert E Seabolt to James Giles and Steven Spurry Re bs risk identification points

Robert E. Seabolt

James Giles

Giles, James

From: Seabolt, Robert E.
Sent: Monday, October 01, 2007 3:26 PM
To: Giles, James; Spurry, Steven
Cc: Eichner, Matthew
Subject: RE: bs risk identification points

Hi Jim,

These look good. My only comment would be maybe to add something regarding Treasury's continuing to build-out its European equity repo platform.

Bob

From: Giles, James
Sent: Monday, October 01, 2007 2:16 PM
To: Spurry, Steven; Seabolt, Robert E.
Subject: bs risk identification points

How do these look?

• Beginning in November 2006, Bear Stearns' Treasury Department embarked on a plan to increase its use of secured funding and thereby reduce its reliance on the unsecured commercial paper market and on uncommitted bank lines. There were two cornerstones of this plan. First, the firm's New Product Approval Committee approved the use of tri-party equity repo transactions as an additional source of secured funding. The firm quickly signed up counterparties to repo corporate securities, both corporate equities and corporate and municipal bonds, on a term basis. Secondly, Treasury began negotiating asset-specific committed secured term facilities for certain asset-backed and mortgage backed inventory that the business hadn't traditionally self-funded, such as foreign whole loans (both commercial and residential), auto loans, tax liens, etc.

By early summer 2007, the firm had made substantial progress on its initiatives reducing commercial paper substantially and increasing the liquidity pool. This progress proved to be very fortuitous, as concerns about Bear Stearns' business, after the collapse of two of its sponsored hedge funds, prompted S&P to change its outlook on Bear Stearns' debt to "Negative" on August 3rd. This rating agency action and a poorly received investor call that followed led to a significant amount of anxiety around the Bear Stearns' name. This idiosyncratic news, along with the general stress in the funding markets in August, led us to begin monitoring Bear Stearns' liquidity on a daily basis, starting with a visit to the firm on Sunday August 5th.

By the time of its third quarter earnings call, the firm had been able to raise its liquidity pool to a record level and dramatically reduce its short term unsecured debt. The firm was able to achieve this result with aggressive balance sheet management and the sourcing of additional secured funding. Despite the success of managing through this difficult time, the firm still has a significant amount of secured funding on an overnight basis. This level of overnight secured funding coupled with the short-term unsecured debt is too large relative to the liquidity pool for the business to be able to turn back on the offensive. We will continue to closely monitor the firm's ability to increase the term on its secured funding to help it operate at a more optimal level.

• Over the past year, we have highlighted the lack of sufficient resources in the Model Validation Group at Bear Stearns. It started in 2006 with the departure of a couple of experienced personnel responsible for model reviews in the credit and equity derivatives. Then, in the spring of this year, the Head of the Model Validation Group resigned. In the interim, the Chair of the Model Review Committee, to whom the Head of Model Validation reported, took over much of the responsibility for the group. However, as a result of the lack of

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capacity, the group temporarily reduced its mandate and relied more heavily on the product-line risk managers within the Risk Management Department for model control work. However, at our monthly risk meeting in September, we were informed that the firm had hired a new Head of Model Validation who would start on September 28th and will be located in London. At our meeting in November, the new Head of Model Validation with provide an update on personnel, focus of the group, and the key model validation work performed over the previous quarter.