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MEMORANDUM FOR THE RECORD

Event: Interview with Sam Molinaro, former Chief Financial Officer of The Bear Stearns Companies, Inc. ("Bear Stearns", BSC, "the Company" or "the firm")

Type of Event: Group interview

Date/Time of Event: April 9, 2010 at 9:30 a.m.

Team Leader: Tom Krebs

Location: Paul, Weiss, Rifkind, Wharton & Garrison LLP ("Paul Weiss")
1285 Avenue of the Americas
New York, NY

Participants:

Non-Commission

- Sam Molinaro
- Michael Chepiga, Partner – Simpson Thacher & Bartlett LLP
- Jacob Press, Associate – Simpson Thacher & Bartlett LLP
- Eric Goldstein, Partner – Paul Weiss
- Jessica Carey, Associate – Paul Weiss
- Matthew Cipolla, Associate – Paul Weiss

Commission

- Tom Krebs
- Mina Simhai (via phone)
- Greg Feldberg (via phone)
- Landon Stroebel (via phone)
- Desi Duncker

MFR Prepared by: Desi Duncker

Date of MFR: April 14, 2010

Interview Summary:

Please note the following:

- *This is not a transcript of the interview and should not be quoted as such.*
- *This is merely a synopsis of Mr. Molinaro's comments and is not necessarily a statement of fact or of the opinions of the FCIC team.*
- *In some cases, answers were rearranged to place into appropriate topic areas. The content was not changed—only the order in the document.*
- *In most cases, Mr. Molinaro's questions were prompted by questions from the Commission interviewers.*

1. Bear Stearns

Jeff Urwin and David Glaser were the co-heads of Investment Banking and reported to Allan Schwartz. Jeff Farber was the Controller and Mike Minikes was the Treasurer—they both reported to Mr. Molinaro.

There were two principal factors in BSC's failure.

i) The Company's role in the MBS industry. Bear Stearns was the leading underwriter for 15 years. The dramatic changes in the market in '07 impacted everyone in the industry. This required Bear Stearns to hold significant inventories of mortgage loans and MBS.
ii) For anyone who was a participant in this market, there was a panic that swept through the financial industry. Funding was confidence-sensitive.

BSC was a leader in mortgage-backed debt, including ABS, RMBS, and CMBS. The mortgage business was important to BSC for Mr. Molinaro's full twenty years there. In Fixed Income, Warren Spector had the ultimate responsibility. BSC's origins in the mortgage market predate Mr. Molinaro's time at the Company, but Bear Stearns had developed an expertise. Towards the end of 2006, BSC began to develop direct origination business. Previously, BSC was in the conduit business. They were intimately involved in the finance, and would decide which loans they would securitize.

This was a competitive marketplace and the whole market was migrating. Alt-A was a significant part of BSC's business. BSC's business model was for distribution. "We're in the moving business, not the storage business." Bear Stearns come to hold securities via two ways:

i) Pieces of the deal that were harder to market; and
ii) Client expects BSC to be a market-maker, and the Company has to be prepared to buy back pieces that were sold. Not just the equity tranches, but it could be any unsold piece.

In 2006, BSC instituted the practice of not conducting principal business with the BSAM hedge funds.

People didn't know what was held and where, as these were ratings-dependent. All confidence was lost.

People had lent money on these securities in the repo market, and there was a loss of confidence in the underlying assets. SIVs and other structured vehicles stopped buying and, in fact, were liquidating. Investors became concerned about credit. Unsecured creditors were subject to the herd mentality, as the prime brokerage market was demonstrating.

When asked which hedge funds were leaving, Mr. Molinaro said it was tough to name names two years later, and that it hit every investment bank. He noted that hedge funds were moving to commercial bank, which were the safe havens. Mr. Molinaro said that there were lots of rumors about people acting improperly, but that he can't substantiate any of them.

The compensation pool was determined by the Executive Committee. The bonus pool was tied to ROE, and was determined by the Board's Compensation Committee. Half was paid in cash, half was paid in restricted stock that vested over three years and had to be held for five. The compensation plan was approved by shareholders. The Compensation Committee consisted of Vincent Tese, Carl Glickman, Frank Nickel, and Don Harrington. Jimmy Cayne would put forth a recommendation.

Mr. Molinaro's latest base salary was $250,000 and his total salary (the total value of his package) was $20 million.

Mr. Molinaro replaced Bill Montgoris as Chief Financial Officer and also became the Chief Operating Officer in 2007. The latter decision was made concurrently with the decision to dismiss of Warren Spector.

2. Bear Stearns and the Mortgage Market

The first signs of stress in the MBS market were in March 2007, when there were elevated defaults in subprime, particularly in the current vintage ('06). Subprime securitizations plunged in value. Bear Stearns had some exposure, so they took write-downs on those assets in March. The market was attempting to adjust. BSC didn't have much subprime—their issues were second-lien loans.

BSC marked all financial instruments daily. Dealers are the primary source of pricing. BSC would look at dealer prices and, to the extent that the security was not trading, they used models. There was a very robust process of risk management to independently verify.

3. BSAM Hedge Funds

In April 2007, the BSAM hedge funds had had a great two-year run of successful returns to investors. Then they suffered a down month, and there was a growing concern in the market on the value of subprime assets. The High-Grade Fund had 8-10 times leverage, and the Enhanced Value Fund had higher leverage. The Fund was buyer of AAA MBS & ABS, acquired from distributors, and bought product from Wall Street dealers.

As CFO and member of the Executive Committee, Mr. Molinaro was concerned about the growing wave of redemptions. The fund was confronted with a significant level of redemptions. The choice was between either redeeming or gating. Ultimately the decision was made to gate the funds. This signaled that there was a problem, so the lenders moved in. The gating of the funds was discussed at the Executive Committee. Rich Marin, the Head of BSAM, Greg Mintel, the Head of BSAM Risk Management, and Ralph Cioffi, the fund manager, were reporting to the Executive Committee on a regular basis.

Repo lenders started to make margin calls, so they had Michael Alix look at the risk in the funds. They put a larger BSC team to look at the hedge funds, including Tom Marano and Paul Friedman. The BSAM hedge funds were borrowing money in the repo markets, usually from the sellers. They had been big buyers of CDO paper, which became questionable as asset prices fell.

Mr. Molinaro didn't recall a discussion of the $500 million investment in the funds. A presentation was made to lender seeking a standstill agreement, and they brought in a restructuring advisor. However, the lenders didn't acquiesce, and Merrill Lynch was the first to seize collateral.

Bear Stearns didn't have a direct counterparty relationship with the funds. But they were getting criticism about not backstopping the fund, even though they were not legally obligated to do so. They decided to make a repo loan to the funds to take out unfriendly lenders, and do an orderly unwind. They ultimately concluded that investors were wiped out in the Enhanced Value fund. Mr. Molinaro didn't recall the exact vote, but noted that Jimmy Cayne was the most strident in his view not to get involved.

Some of the repo lenders to the BSAM hedge funds were the same firms that lent to BSC. Some large banks were not happy with Bear Stearns. Reputationally it was a problem, both with customers and with the media dragging BSC through the mud. Mr. Molinaro believed the cost of the funds was $1.6 billion, and he didn't have direct knowledge of the details of Merrill Lynch seizing collateral. He noted that Tom Marano, Ralph Cioffi, and Warren Spector would have the details. This ended the drama of liquidation, eliminating the repo lender program. Taking on $1.6 billion in repo caused concern among BSC investors, but it effectively brought the hedge funds to a close. They were in the process of trying to liquidate the fund.

Bear Stearns got pinned as being exposed to subprime, whether or not it was true. Markets were fearful over who had subprime exposure. There were seeds of panic.

4. S&P and SEC

Standard & Poor's (S&P) was concerned about the potential significant downturn. S&P was doing a review of all of the firms and ultimately put Bear Stearns on negative outlook. BSC management felt that S&P was underestimating the impact of their action on BSC's liquidity picture. The S&P action did cause a panic, as CDS spreads significantly widened as there was a growing uneasiness stemming from the BSAM hedge funds. BSC decided that they needed to have an investor call to assuage concerns. Their hands were tied in terms of having direct conversations with clients, so they decided to have a public call. The market's initial reaction was that the stock market sold off, and there was heightened anxiety.

In general, Bear Stearns met with the rating agencies about once or twice a year.

Mr. Molinaro did not specifically recall the meeting with the SEC. There were three people who were direct liaisons: Mike Alix, Bob Upton and Jeff Farber (who had less frequent dialogue, but was still in discussions). The SEC people Mr. Molinaro dealt with were Mike Macchiaroli and Matt Eichner. The SEC concerns were mortgage exposure, liquidity profile/reserve cash positions, and net capital positions. The discussions were daily for a period of time, and they were getting monthly reports. Bear Stearns was telling the SEC the total balance of liquidity pool, and the SEC was getting a comprehensive review. The SEC put out a clarifying statement stating that they had no concerns. The investor call positioned BSC to go speak with clients. Bear Stearns had an Investor Day on August 4, 2007. They hosted investors, outside clients, and rating agencies, and made a presentation.

During 2006, business on Wall Street was booming, and Bear Stearns was concerned about reliance on unsecured financing. They made a decision to shift to secured financing (repo). This was more expensive, as repo is generally more expensive. This enabled BSC to weather the storm in 2007. The SEC agreed, and Mr. Molinaro suspected that everyone was doing some version of this.

In 2006, people were saying there was 'no contagion' from subprime to other areas such as Alt-A. Housing prices were starting to decline, and the market was unstable. BSC had a $1.2 billion write-down. The biggest components of this were some assets that they took from the hedge funds, as well as warehousing lending facilities with CDO originators that had to be liquidated.

Derivatives played a role in a variety of ways.

i) Dealers have big books of business, and they have to make all those positions;
ii) CDS markets allowed people to buy protection; and

iii) The counterparties can look to assign their name away. In a panicked market, there is a destabilizing impact of other dealers getting lots of novations.

BSC was having discussions with other dealers about the novation process. The dealers assured Bear Stearns that they were open for business with Bear Stearns.

The volume of activity created breaks because you had to make sure you know who you're exposed to. When a novation takes place, money shifts around.

5. Risk Management at BSC and the Oliver Wyman Report

Oliver Wyman is a consulting company with a focus on risk management. In the fall of 2007, Bear Stearns brought them in to work with them in the restructuring of the risk management process in the firm. There were meetings to review the report. As part of Warren Spector's departure, they were reorganizing. Mr. Spector was the major decision maker when it came to market risk-taking. BSC management worked with Oliver Wyman to institute best practices.

The culture of the firm is such that decision-making is on a real-time basis. "Infrequent and ad hoc"—they wanted to maintain real-time nature and put in resources to support this. Mr. Molinaro didn't recall what Oliver Wyman was getting at with their specific recommendations. He disagreed with their implication that risk management didn't have a seat at the table. He said he would agree that they didn't have the robust procedures that Oliver Wyman recommended (*i.e.*, firmwide VaR calculations, scenario analysis infrastructure). (VaR (Value at Risk) is a measurement of risk. They calculated VaR on a daily basis, but did not use it as a key management tool.) At the BSC, the risk management roles were focused on surveillance, monitoring, price verification, etc.

BSC was in process of working on Oliver Wyman's recommendations.

6. Last Days of Bear Stearns

In March 2008, BSC had transitioned leadership from Jimmy Cayne to Alan Schwartz. The business conditions were seemingly firming, and they were getting back to business as usual, albeit in a dislocated fixed income environment.

Mr. Molinaro was not present at the March 4th meeting with the Fed. He was in Europe and was back in the office on Monday, March 10th. On the 10th, the stock was down and CDS spreads were widening. One of the rating agencies put a downgrade on securities BSC issued. The headline showed a downgrade of Bear Stearns, and many people didn't bother to see the detail.

At some point on Monday morning, Ace Greenberg called from the trading desk and Mr. Molinaro tried to get an update. Mr. Greenberg took a call from a reporter. Mr. Molinaro didn't know he was going to give a statement, and it was a bit ad hoc, but it was accurate. That morning, there was no reason to believe that there would be a problem. Mr. Molinaro called around to the risk people to see counterparty risk. He called the operations people to get info on margin calls. He called the prime brokerage desk. He saw nothing unusual. Mr. Molinaro confirmed to the FCIC the reported $18 billion reserve balance.

They made a determination to have an official statement on record.

That week, they were in pretty steady contact with the SEC, and were keeping them briefed. On Tuesday, it was more of the same, stable. They were seeing prime brokerage clients pull money out and some margin calls, but it wasn't material. They told CNBC everything was fine.

The novation situation was not readily apparent. On Tuesday, the liquidity situation was stable. Prime brokerage transfers were stable—the biggest concern was the loss of the business, not liquidity. The reserve balance was down a little, but was still stable.

Mr. Molinaro stated that we wasn't on CNBC, but that he talked to Charlie Gasparino.

On Wednesday morning, Mr. Schwartz spoke on CNBC to address the unsubstantiated rumors. During the day it was business as usual, and they continued to deal with prime brokerage clients. Later in the day, Bear Stearns started to feel stress in repo financing and a reluctance to roll over from large counterparties (the usual suspects, *i.e.*, Fidelity). Their risk management departments were concerned.

Mr. Molinari got a report from the repo desk that they were having trouble. This included Paul Friedman, Tim Green, as well as Bob Upton and John Stacconi from the Treasury group. The close of business was not done, but the tone had changed and they were worried.

There was an irrational fear that left Bear Stearns susceptible to a run. On Wednesday evening, there was a Liquidity Committee meeting. They were looking at what asset they needed to sell. They were assuming that they had more time. BSC had some contact with the Fed and Treasury. They reached out to try to get access to the discount window. Mr. Molinaro said he believe that it was that Tuesday when the Fed had announced a program to lend Treasuries collateralized by MBS.

On Thursday morning, most of the repo rolled. (Mr. Molinaro said from his understanding of repo, most of the action occurs early in the morning and later in the day.) Later in the day, counterparties were telling Bear Stearns that they would not roll the next day. BSC needed to find a backstop liquidity line. Additionally, they had redemptions from prime brokerage customers.

They hired a banker, Gary Parr from Lazard. They reached out to Jamie Dimon, who brought his team. They sat down on Thursday evening to review the situation, including what BSC was concerned about not rolling. There were questions back and forth, and JPM said they would reach out to the Fed, as they felt that the funds that Bear Stearns were needed were in excess of what JPM could provide.

Bear Stearns was in close contact with the SEC, and they reached out to the SEC on Thursday to tell them what was happening. Mr. Molinaro said he thought that Alan Schwartz and Michael Alix might have talked to the Fed, but that JPM was the one who brought the Fed into the picture.

JPM was the conduit on the 28-day facility, but effectively they were facing the Fed. There was a Friday morning announcement, but the market didn't react well. They had a late morning conference call to explain the facility, give an update on their situation, and to say that they were exploring strategic alternatives. Initially the market went up, but then it sold off.

Alan Schwartz got a phone call from Hank Paulson, who told Mr. Schwartz that he had the weekend to get a deal done, as the facility would not be rolled over on Monday. Mr. Schwartz told Mr. Molinaro on Friday night, and they met with JPM in due diligence meetings, along with potential investors such as Chris Flowers. The deal was constructed on Sunday evening.

7. Cash Capital Concept

Bear Stearns uses a concept called cash capital. Readily marketable and liquid assets can be funded using the asset's self-funding ability. Other assets such as non-agency whole loans need long-term financing (*i.e.*, long-term debt and equity). For example, Treasuries might require only 20% cash capital (that is, long-term financing), while non-agency whole loans would require 100% cash capital.

8. Causes of the Financial Crisis

The financial crisis was caused by the price appreciation fueled by lax lending standards. This was fueled by leverage, defined by opacity, and blessed by the rating agencies. With real estate collapsing, which was tremendously unforeseen, there were significant losses.

Mr. Molinaro didn't think there was anything they could have done. As he put it, they were in the mortgage business, and they did it as safely as they could. Market forces moved. In hindsight, it would be hard to believe that BSC could survive a market where Countrywide, Fannie, Freddic collapsed.

There was some concerns about the level of Alt-A. They underestimated the lack of liquidity in those securities.

Investment banks are susceptible to crises of confidence. They were holding assets that should be liquid but weren't.

Check the Box If There Are Any Particularly Interesting Quotes: _X_

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