

MEMORANDUM FOR THE RECORD

Event: Interview with Paul Friedman, former Bear Stearns COO

Type of Event: Group interview

Date of Event: Wednesday, April 28, 2010

Team Leader: Tom Krebs

Location: Paul Weiss, New York, NY

Participants - Non-Commission:

- Paul Friedman, former Bear Stearns COO
- Eric Goldstein, Paul Weiss
- Jessica Carey, Paul Weiss
- Rachael Miller, Paul Weiss
- Fred Fielding, Morgan Lewis
- Ivan Harris, Morgan Lewis
- Melissa Mitchell, Morgan Lewis

Participants - Commission:

- Tom Krebs
- Donna Norman
- Sarah Knaus

MFR Prepared by: Sarah Knaus

Date of MFR: April 28, 2010

Summary of the Interview or Submission:

EXHIBIT 1: Paul Friedman CRD

Tom Krebs began the interview by showing Mr. Friedman his CRD. He then introduced himself and the FCIC. Tom told Mr. Friedman that although he is not under oath during the interview, we're taking notes to facilitate correct responses. Also, under 18 U.S.C. 1001 you're obliged to tell the truth.

KREBS: Are you currently employed at Guggenheim?

FRIEDMAN: Yes.

KREBS: And to whom do you report?

FRIEDMAN: Alan Schwartz.

KREBS: Did you report to Alan Schwartz at Bear Stearns?

FRIEDMAN: No.

KREBS: To whom did you report at Bear Stearns?

FRIEDMAN: Warren Spector, Steve Meyer, and Craig Overlander.

NORMAN: What was your precise title?

FRIEDMAN: I was a Senior Managing Director. The COO title was picked up by Bill Cohan in the book (*House of Cards*) but there was no such title as COO of Fixed Income. I had been there a long time and had helped the department, but I was not COO.

KREBS: Have you discussed your prospective testimony today with Mr. Schwartz?

FRIEDMAN: No, not really.

KREBS: Have you reviewed any documents?

FRIEDMAN: I don't think so.

KREBS: Please describe your duties at Bear Stearns.

FRIEDMAN: It was a difficult job to describe. I started with Bear Stearns in 1981 in the operations area. I was in a Special Projects Group within the operations role, putting out fires and jumping in as needed. I would get a call that something was out of balance within a department. It was fire fighting general projects.

KREBS: What is your background?

FRIEDMAN: I have a degree in economics from Colgate, a Master's in finance at the NYU School of Business, and I spent 5 years in accounting before Bear.

At Bear, I was moved to overseeing part of the mortgage business, for customers that we cleared for securitization. I did that for about a year. I told the person that I worked for that I was not happy in operations, and ended up as a trading assistant processing trades, in a fairly clerical position. In mid-1983, I moved on to the mortgage trading desk, where I spent two years as a trader, trading esoteric from 1983-85. In 1985, Dennis Coleman ran Fixed Income and he asked me to come work for him as a chief of staff, an aid to help him run the division. Not to make any decisions, but help administratively. I worked for him until his retirement in 1991 or 1992. Phil Mickelman took his position and I stayed on.

Ultimately, I worked throughout my career for the person or persons running Fixed Income. As I stayed on and was promoted, I took more authority. Some of the departments from the middle office group and repo desk reported to me. And because I had been there for a long time and I had worked in the back office, as a trader and on the management team in production, I was the one relied on if there was something needing to process. They would say that "Paul would be able to get it done". Hence the quasi-COO position. I knew a lot of people at the firm and was good at making things flow.

KREBS: Kind of a trouble shooter?

FRIEDMAN: Yeah. The reason the COO title was sort of used, was that I would sit at tables with customers and outsiders, and I would have to describe like I just did. As a short hand we'd use COO.

KREBS: You've been quoted quite actively including in Mr. Cohen's book. Have you read the book?

FRIEDMAN: I read it. I found it almost physically unnerving to read.

KREBS: Do you agree with some of the quotes attributed to you?

FRIEDMAN: The words are accurate but sometimes they were not used as I would have used them.

KREBS: What are the exceptions to the statements in the book?

FRIEDMAN: The one that's the least significant, but most annoying to me, is that the book says that on Sunday night on March 16, a group gathering in my office ultimately decided to moon JPMorgan. This never happened and has been corrected in subsequent editions.

KREBS: Were these interviews taped?

FRIEDMAN: Other than the situation I just mentioned, they were taped.

KREBS: What did you find out about BSAM in summer 2007?

FRIEDMAN: I had been asked to go to the hedge fund because Ralph Cioffi had some funding issues and he was having trouble meeting margin calls. I was focused on liquidity. I found that they had a portfolio of fairly illiquid securities. Their funding was fairly short-term and they were having trouble meeting them.

KREBS: Were you in charge of the repo desk at Bear?

FRIEDMAN: Yes.

KREBS: Would you make documents available to the SEC related to the status of the repos and send them reports in conjunction with your position?

FRIEDMAN: Starting in August of 2007, the SEC asked for a report on our funding. People who worked for me prepared it and I sent it to the SEC.

KREBS: Were these reports accurate?

FRIEDMAN: I think so.

KREBS: Let's go back to hedge funds. What got them to the position where they ultimately were in danger of failure?

FRIEDMAN: Their business model was that there was a place for someone who had the ability to understand complicated securities and spend the time analyzing, to go out to buy them and earn a higher return because there were fewer investors.

They were buying securities and investing them. They were rather highly rated back when everyone believed ratings. What we found rather quickly was that the business model works when you're buying securities, but when you're trying to sell them, potential buyers need a lot of time to study the securities. This doesn't lend itself to quick sales.

KREBS: Isn't it true that the financiers to the hedge funds were the sellers of the investments to the funds?

FRIEDMAN: Yes.

KREBS: And Bear Stearns sold a number of these to the hedge funds?

FRIEDMAN: I believe so.

KREBS: Are you aware of a Massachusetts case against Bear Stearns?

FRIEDMAN: I know of it from reading it in the press but was not involved.

KREBS: Do you know if there was a bar against the hedge funds doing business with Bear Stearns?

FRIEDMAN: At one point there was, yes.

KREBS: At what point was that?

FRIEDMAN: Mid-to-late 2006 I think.

KREBS: And was that bar observed, or was it observed in the breach?

FRIEDMAN: I believe it was observed.

KREBS: Was this before or after Mr. Spector pushed down an additional \$25 million to these funds? Are you familiar with that?

FRIEDMAN: Yes, but I'm not entirely sure.

KREBS: With respect to the funds, what oversight was given to Cioffi and Barren?

FRIEDMAN: They reported to Spector, I know they met from time to time but I wasn't really involved in it so I don't know to what depth.

KREBS: Was the first time you were involved in the funds when you went down to oversee them?

FRIEDMAN: Yes.

KREBS: Who went with you?

FRIEDMAN: Initially I went alone, but I later went in with Marin, Iannin, and Ralph Cioffi and the others.

KREBS: Ralph talked to you about what was going on in the fund?

FRIEDMAN: Yes.

KREBS: Did he describe to you his current funding situation with respect to those two hedge funds?

FRIEDMAN: Yes.

KREBS: What did you tell him?

FRIEDMAN: I told him he had a problem.

KREBS: Didn't you tell him he was "done"?

FRIEDMAN: I don't remember that phrase.

KREBS: What was the problem?

FRIEDMAN: He had difficulty raising cash to meet margin calls. A month earlier he had suspended redemptions in the fund, which triggered a series of margin calls from the street. He had an increasing set of demands from lenders.

KREBS: Is it your opinion that the decision to gate the funds was made by Mr. Marin and Ralph Cioffi?

FRIEDMAN: I don't know.

KREBS: Were you at a meeting where the decision was made to gate the funds?

FRIEDMAN: I was not.

KREBS: Did you report back after going to see the funds, and if so, to whom did you report?

FRIEDMAN: I came back to talk to Spector. It wasn't a formally written report but I told him what I saw.

KREBS: What did you tell him?

FRIEDMAN: I told him Ralph had a real problem and we needed to fix it.

KREBS: What was his reaction?

FRIEDMAN: Keep me posted.

KREBS: In time, with respect to the repo lenders for the high-grade fund, why was there a decision to place funds in the High Grade Fund and not the Enhanced Leverage Fund?

FRIEDMAN: We didn't put funds in. We took the repo lenders out and became the repo lender. There was a series of discussions at the Executive Committee, some of which I was present for.

There were two schools of thought. The first believed that the lenders had made the determination that Bear Stearns was the sponsor of the funds, but the company was not responsible for their fate. We could walk away and let the Street deal with it as they wanted to. Others said that hedge fund lenders were lenders to Bear Stearns and there would be repercussions for doing nothing.

We explored a series of decisions, including becoming one of a series of lenders, but these ultimately fell apart. We came to a deadline when a number of lenders were about to seize the collateral and liquidate.

The Executive Committee decided that the Enhanced Leverage Fund was dead, and the High Grade had a lot of collateral and could work through the liquidation of the collateral on short notice.

NORMAN: Were the lenders in the Enhanced Leverage Fund the same as in the High Grade Fund?

FRIEDMAN: They were the same.

KREBS: Did you mean to imply that the hedge funds were the principal repo lenders to the hedge fund?

FRIEDMAN: No, among the lenders were Citibank and Deutsche Bank.

EXHIBIT 2- Merrill Lynch Analysis, Bear Stearns Mgm't: Timeline & ML Exposure

KREBS: You probably have not seen this document because it was generated by Merrill Lynch.

FRIEDMAN: I have been shown a form of it by counsel.

KREBS: With respect to page 12, are the timelines of recent events generally accurate as far as you know?

FRIEDMAN: I don't have any knowledge of the June 29 date of Merrill Lynch payments.

KREBS: With respect to the repos and derivatives, do you know if they are generally correct?

FRIEDMAN: In a broad sense they feel sort of right, but I don't really remember.

KREBS: Didn't Merrill Lynch seize collateral and attempt to sell those?

FRIEDMAN: Yes.

KREBS: What happened with that attempt to sell the collateral?

FRIEDMAN: They seized the collateral and gave bidders less than 24 hours to bid on the collateral. We didn't participate in the bid, at least to my knowledge, so my only feedback was anecdotal. It was not well-received and we did not receive any bids. I heard second- or third-hand that the bids were very low.

KREBS: With respect to those particular hedge funds, did the low bids impact similar securities?

FRIEDMAN: Um.

KREBS: Did Bear Stearns hold the same securities in their portfolio?

FRIEDMAN: Generally not. Bear Stearns was not a large participant in this sector of the market.

KREBS: Bear was not a big synthetic CDO issuer?

FRIEDMAN: Not particularly.

KREBS: Is there a reason for that?

FRIEDMAN: I think there was but I don't know. The big banks had an advantage in that business.

KREBS: Do you think Merrill Lynch is correct about what went wrong?

FRIEDMAN: I think it's directionally correct, but there are a few statements I'd disagree with. I don't understand the term "opaque marks."

KREBS: You just told us that when Merrill Lynch was trying to get the securities out they could not drill down and make a determination of value, would you agree with that?

FRIEDMAN: I would say that given very short notice on complex securities people had difficulties deciding what they were worth.

KREBS: [reading from the exhibit] "Exposed to mark to market and margin calls?" That was true but with respect to lenders

NORMAN- Did you have an opinion of what the securities were worth?

FRIEDMAN: I didn't. I didn't know if they did or didn't or if on short notice they didn't want to bid.

NORMAN: Do you know if they were market observables?

FRIEDMAN: I would agree with that. "Had no term funding," is untrue, the funds didn't have much but they didn't have none.

NORMAN: do you know how much?

FRIEDMAN: At the time I would have, but not now. It wasn't the lack of term funding, but the margin calls.

NORMAN: Do you know what BSAM's average overnight repo was?

FRIEDMAN: No.

NORMAN: Any idea?

FRIEDMAN: None.

NORMAN: Can you ballpark?

FRIEDMAN: No idea. I didn't look at BSAM at all.

NORMAN: Sorry, the two funds?

FRIEDMAN: Less than 20% I think so.

KREBS: when SEC came in after the failure of these funds and you talked with them, who did you talk with? Matt Eichner?

FRIEDMAN: That's the only name I remember but there were others.

KREBS: Macciaroli?

FRIEDMAN: I don't think so.

KREBS: How often did you meet with Mr. Eichner?

FRIEDMAN: The only time was August 4th or 5th at Bear Stearns.

NORMAN: The only time ever or regarding the BSAM funds?

FRIEDMAN: It wasn't regarding the BSAM funds, but it was the only time I remember meeting with him.

KREBS: From time to time did you have to generate repo- or liquidity-type reports to the SEC?

FRIEDMAN: People who worked for me generated them and I sent them.

KREBS: [reading from exhibit] "Leverage, high grade 6:1 enhanced 12:1"?

FRIEDMAN: It feels in the neighborhood as being correct.

KREBS: Do you agree with the bullets underneath?

FRIEDMAN: Yes, yes, reasonably true.

KREBS: The crisis management issue?

FRIEDMAN: The third bullet point is an opinion, it's not a fact. I don't know if it was true or not true but it's obvious that it's an opinion. It would have been naïve to assume that we could get the margin calls, but it probably isn't surprising they weren't willing to wait. The bullet point stating "failure to move quickly:" I think we moved quickly and went through a lot of alternatives but they fell through and we ended up with what we could.

KREBS: Did you attend a meeting where you discussed the high grade fund?

FRIEDMAN: Are you referring to the Exec Committee, then yes.

KREBS: Did you hear Ace Greenburg say that our [Bear Stearns'] name is behind the fund and we need to stand behind it?

FRIEDMAN: Yes.

KREBS: And that carried the day?

FRIEDMAN: Yes it did.

KREBS: What committees did you serve on?

FRIEDMAN: The Operations Committee, Credit Policy Committee, New Products Committee, and I was on the Global Finance Committee.

KREBS: What issues were taken up by the Global Finance Committee?

FRIEDMAN: Global in the sense of BS worldwide. The Global Finance Committee was looking at the funding model at BS, the way in which we issued debt, the extent to which our funding mirrored our business.

KREBS: What was the funding model at BS during the summer 2007?

FRIEDMAN: It was evolving over time. Starting in early 2007, there was a concerted effort. You've met with Upton, who led the finance committee towards a more secured funding model. There was an increase in secured funding reliance on equity and repo, and a reduction in reliance on CP. The basic premise was that in a funding crisis, your unsecured lenders would be the first to leave you and the secured lenders would be more likely to stay.

EXHIBIT 3- Consolidated Financial Statements

KREBS: These two pages are a portion of the consolidated financial statements. Do the "liabilities in stockholder equity," represent repos?

FRIEDMAN: Yessir.

KREBS: At end of the year 2006, the repos totaled \$69 billion, and at the end of 2007 they totaled \$100 billion?

FRIEDMAN: Yes

KREBS: does this show the model change to BS?

FRIEDMAN: Yes.

KREBS: Next page, "securities" equal \$69 billion.

FRIEDMAN: Yes.

KREBS: After the funds failed, S&P issued a negative outlook report on BS, didn't that adversely impact your ability to go to the commercial paper (CP) market?

FRIEDMAN: I don't think so. I don't remember hearing anyone say that we couldn't issue CP. It probably impacted the rate of issuance, but no one walked away.

KREBS: At the time you were transitioning into repo?

FRIEDMAN: Yes.

KREBS: Was it term or overnight?

FRIEDMAN: A significant portion of it was term.

KREBS: In October 2007, did State Street eliminate its term repo and go into only overnights?

FRIEDMAN: I don't think so.

KREBS: Mr. Spector left right about the time of the publication of the negative outlook rating, and following the bankruptcy of the BS hedge fund. What happened at BS upon his leaving?

FRIEDMAN: That's fairly broad, can you help me?

KREBS: Did Mr. Schwartz take over as CEO and did he study what had gone on at BS and study what was going on?

FRIEDMAN: I don't believe he took over as CEO when Mr. Spector left. I don't think so.

KREBS: Was there a study by Oliver Wyman, following Mr. Spector's departure?

FRIEDMAN: There was a study by Oliver Wyman, probably after Spector's departure.

KREBS: Were you made privy to the results of their study?

EXHIBIT 4: Oliver Wyman Report

KREBS: Do you recall the thrust of the studies engaged in by Oliver Wyman?

FRIEDMAN: I knew the topic related to governance and risk management, but that was all I knew. They came in and asked me questions and that was it.

NORMAN: They interviewed you, what were they interested in?

FRIEDMAN: Credit risk.

NORMAN: What was the result of those discussions?

FRIEDMAN: It was only an hour that I spent with them two years ago. I had been on the Credit Policy committee for almost 20 years, and I talked to them about BS's counterparty evolution and what my views were.

KREBS: What are your views on it?

FRIEDMAN: At the time, I was generally a believer in dealing with somewhat less credit worthy counterparties if you get enough collateral. Up until the market proved me wrong I was a believer that you could always be protected by collateral and process.

KREBS: Because it was cheaper?

FRIEDMAN: I don't know if it's cheaper but because there are lenders.

NORMAN: Why would you deal with somebody who's less credit worthy?

FRIEDMAN: It was difficult for a smaller firm like BS to have the raw counterparty risk that banks had. Banks were used to taking unsecured risk based on the borrower's ability to repay. Firms like BS had to do something differently to compete, so we'd be more willing to look at collateral. I believe that historically collateral was more important than character. It's a different way of looking at the loan.

KREBS: Was the consultant suggesting that BS was dealing with lesser credit worthy counterparties?

FRIEDMAN: They didn't make any suggestions to me, they just took notes and listened and moved on.

KREBS: Did they ask you about counterparty concentration?

FRIEDMAN: I don't think so.

KREBS: In your risk management capacity, have you ever had discussions about the counterparty concentrations Bear Stearns had?

FRIEDMAN: I actually had no risk management role.

KREBS: I take it you spoke to risk management people about that, and you were on the Credit Policy committee, did you ever talk to Michael Alix's group about this?

FRIEDMAN: I don't think so.

KREBS: Did you ever feel it was too concentrated?

FRIEDMAN: I don't think so.

Mr. Friedman's lawyers interrupted, explaining that Mr. Friedman was talking about lending, while Tom was talking about borrowing. Everything that Mr. Friedman had been talking about was about lending.

NORMAN: You had counterparties on both sides?

FRIEDMAN: Some.

NORMAN: Was the concentration on the borrowing side discussed?

FRIEDMAN: From time to time.

NORMAN: You're not talking about the meeting with Oliver Wyman?

FRIEDMAN: That's what made me think about it. I don't have any memory of them bringing it up, but it was talked about from time to time.

NORMAN: Did BS ever change their limitations?

FRIEDMAN: We had limitations on how much CP any one lender could have. I don't remember feeling there was undue concentration.

NORMAN: Any limitations to unsecured or repo lending on concentration?

FRIEDMAN: I don't think so, I think the lenders governed how much they would lend to anyone.

NORMAN: In hindsight do you think it was concentrated, when you think of Fidelity and Mellon not rolling repo?

FRIEDMAN: I don't know that it was one of the causes of what happened. In hindsight it's hard to say what that impact was, but I don't think of concentration as one of the issues.

KREBS: Did you ever have the occasion to review the results of the Wyman study?

FRIEDMAN: I don't think so.

KREBS: Page 4, "gaps in risk management." Would you agree that there was no formal framework for risk appetite at BS?

FRIEDMAN: I wasn't really involved with the risk management side and we had a risk officer with a pretty large staff, so I'm not sure what that would mean.

KREBS: "There's a lack of institutional stature for Risk Management Group: risk managers not effectively positioned to challenge front office decisions; understaffed and low priority in IT queue; cultural resistance to VaR and tail risk measures." do you agree with that?

FRIEDMAN: I don't know how they did with IT projects. I thought Mike Alix was a senior guy and his people were very capable of reporting to him, and he reported to the Executive Committee. I don't know what more you can do other than have the CRO report to the Exec Committee. I don't know what tail-risk measures are.

KREBS: Does this speak to the availability to speak with the board or with traders as far as transactions?

FRIEDMAN: I'm not sure, it's an odd statement to me. The risk management staff talked to traders constantly, so I'm not sure what it means.

KREBS: Bullet 2, "Vacuum created by departure of Warren Spector." Had his ship sailed by the time risk management got involved?

FRIEDMAN: I don't know, it seems off to me. I wasn't involved in it too much. Trades got discussed and decisions got made, I don't know if Warren's departure stopped their discussions.

KREBS: Who is Oliver Wyman?

FRIEDMAN: They're a consulting firm that holds themselves out as the financial sector version of McKinsey, with a focus on process and favorables.

The interview took a break at this point.

KREBS: After the collapse of the Bear Stearns hedge funds and the publication of the negative outlook report by S&P, what did management at BS do to respond to that negative outlook rating?

FRIEDMAN: I don't know if there was a response to the negative outlook persay that I can think of. I'm not sure what you're driving at.

KREBS: Did they host a telephone conference?

FRIEDMAN: Yes.

KREBS: Did you participate?

FRIEDMAN: No.

KREBS: Shortly after that rating, the SEC came calling. Did you meet with them on a Sunday afternoon?

FRIEDMAN: Yes.

KREBS: What happened at that meeting?

FRIEDMAN: There were a number of people at BS from the risk management group, from the Treasurers group, and we took them through a picture of the firm. I was only there for part of the meeting, so I can only give you a sense of what happened. I was there for the introductions, the latter part of the positions, and the discussion of the firm's funding positions.

KREBS: Following these meetings, did you from time to time prepare reports to the SEC?

FRIEDMAN: People who worked for me prepared them and I sent them.

KREBS: Did you pass them straight on or did you pass them to someone before they went out?

FRIEDMAN: I think I passed them to Upton.

NORMAN: Did you not prepare reports to the SEC prior to the collapse of the hedge funds?

FRIEDMAN: No. I don't know if they spoke to Bob Upton about our funding position.

KREBS: Would you have been expected to know about the mass quantities of the repo data?

FRIEDMAN: Upton had a lot of information and I wouldn't have necessarily have known.

KREBS: Wasn't it your function to monitor repo and the firm's perspective in the repo markets?

FRIEDMAN: I wouldn't say monitor, I oversaw the desk.

NORMAN: other than Upton, would anyone else had provided information to the SEC?

FRIEDMAN: Maybe Mike Alix.

NORMAN: Did you provide the numbers?

FRIEDMAN: I didn't prepare numbers at all.

NORMAN: Who would have provided the repo information to the SEC?

FRIEDMAN: I don't know.

NORMAN: Who had access to it, it's your desk?

FRIEDMAN: Both Upton and Alix.

NORMAN: Because they had access to reports or a database?

FRIEDMAN: As part of producing numbers for the Global Finance Committee, the Treasurers had that information.

NORMAN: From 2004-2007? Certainly from 2006.

EXHIBIT: [Inventory Analysis January 11, 2008 SEC_TM_FCIC_1053383](#)

NORMAN: this is a portion of the type of the document that you prepared and distributed. Was this something prior or was the format developed in response to the SEC?

FRIEDMAN: It was developed after the August meeting.

NORMAN: Is this all information you would have provided to Mr. Upton and Alix?

FRIEDMAN: It is all the information Upton would have had, but more detailed than he would have probably looked at.

KREBS: did the format come from the SEC?

FRIEDMAN: They requested a picture of our funding position, we provided this.

KREBS: Who developed the template?

FRIEDMAN: It was developed by a person who worked for me, who was putting together a picture of what things could look like for the SEC.

KREBS: Column 1, Agency. What securities would that comprise?

FRIEDMAN: Fannie Mae's, Freddie Mac's and Ginnie Mae's to some degree.

KREBS: Non-agency?

FRIEDMAN: Securities structured from whole loans that were not Fannie's or Freddie's.

KREBS: Whole loans?

FRIEDMAN: Unsecuritized loans.

KREBS: Physical?

FRIEDMAN: Physical securities are a subset of non-agency securities, but the settlement process has them physically delivered, not over book entry.

KREBS: Am I to understand that the total outstanding repo for the period was \$98,454,000,000?

FRIEDMAN: That sounds accurate.

KREBS: Do you have any knowledge of how often the people under your supervision generated these reports?

FRIEDMAN: They were generally put together weekly.

KREBS: Would it have been sent to the SEC weekly?

FRIEDMAN: I think so.

KREBS: You only met with them the one time?

FRIEDMAN: Yessir.

NORMAN: Did you also have regular US treasuries?

FRIEDMAN: Yes.

NORMAN: Those were not agencies?

FRIEDMAN: Generally we weren't concerned about financing them. The repo market, even when there were issues, handled treasuries.

NORMAN: Do you know how much additional Treasury repo is not reflected here?

FRIEDMAN: Generally it ran \$20-30 billion probably.

NORMAN: This is a snapshot that reflects that agency collateral is a little less than half of your outstanding repo collateral?

FRIEDMAN: That sounds about right.

NORMAN: Was that right over time, from January 2006-January 2008?

FRIEDMAN: That's a reasonable range.

NORMAN: And the non-agency collateral, what percentage is MBS?

FRIEDMAN: All of it.

NORMAN: Did you further break that down by credit rating?

FRIEDMAN: Yes.

NORMAN: Did you present that information or believe others did to the SEC?

FRIEDMAN: I don't remember if we presented that to them, I'm not sure.

NORMAN: What was your understanding of the composition of the non-agency assets (totaling 25%)? Were there more in any particular credit rated class?

FRIEDMAN: I don't remember.

NORMAN: Was there something you shopped for or actively balanced to keep in a line?

FRIEDMAN: No. What you'll remember is that this is a funding position. The people who worked for me were tasked with funding, not deciding what was being funded for.

NORMAN: Was it something that came up with your overall leverage?

FRIEDMAN: The firm might have, but I don't know, not my world.

KREBS: At the bottom, it says committed/long term trades, what does that mean?

FRIEDMAN: These were trades where the lender had an obligation to lend to us long term, meaning beyond short-term.

KREBS: Is the date the time at which the obligation is extinguished?

FRIEDMAN: I believe so.

KREBS: Was this generally provided to officers at BS, or similar documents?

FRIEDMAN: Not generally.

KREBS: Was there a liquidity report also generated as part of this inventory analysis, there's a note up at the left hand that says tie to liquidity report, who was responsible for generating that?

FRIEDMAN: I'm not even sure what it refers to so I don't know.

KREBS: Were you ever asked to generate a liquidity report?

FRIEDMAN: No.

KREBS: Did you ever hear about a liquidity report?

FRIEDMAN: I don't know.

KREBS: Are you familiar with Thornburg mortgage?

FRIEDMAN: Yes. They were a customer of BS and a borrower of the repo desks.

KREBS: Do you recall how much outstanding they had?

FRIEDMAN: At what time?

KREBS: Right around when they failed, maybe February 2008?

FRIEDMAN: It was around a \$1 billion I think.

KREBS: Did you ever see a report indicating that it was approximately \$1.7 billion?

FRIEDMAN: I may have, it's possible.

KREBS: Do you recall have discussions at BS with respect to Thornburg Mortgage?

FRIEDMAN: Yes.

KREBS: What did they involve?

FRIEDMAN: Thornburg was having trouble meeting margin calls and there were a series of meetings among the creditors to Thornburg, like BS, who were lending them money. There was someone tasked to us on that committee and report back to us.

KREBS: Do you remember what time frame this was in?

FRIEDMAN: February of 2008, it lingered on for quite a while but that's when it began.

EXHIBIT 2- Mortgage Portfolio Update, BSC-FCIC-e00739994

KREBS: Having looked at that, can you tell us what document that is?

FRIEDMAN: It's a summary version of the same report that we looked at earlier, bearing a different date. February 29, 2008.

KREBS: Is that on or about the time that there were difficulties with Thornburg?

FRIEDMAN: I believe so.

KREBS: Is there any way to recognize a reference to Thornburg?

FRIEDMAN: No, this is summary information.

KREBS: What is the outstanding repo?

FRIEDMAN: \$75 billion.

KREBS: And that doesn't include Treasury repo?

FRIEDMAN: Correct.

KREBS: Sitting here today would you have any recollection of the Treasury that was outstanding?

FRIEDMAN: I could guess, I think it's around the \$20-30 billion.

KREBS: Which would make the total treasury repo what?

FRIEDMAN: Around \$100 billion.

KREBS: What was the resolution, if you know, of the firm's dealings with Thornburg?

FRIEDMAN: Ultimately the creditors agreed not to put them into default and to give them a one-year financing without margin calls.

KREBS: They just financed the existing amount owed or just raised capital?

FRIEDMAN: They raised some capital on their own and I think one of the firms, not BS, agreed to give them financing for capital.

KREBS: Did BS hold any of the securities owned by Thornburg?

FRIEDMAN: I don't know.

KREBS: Do you know if any of the mortgage-backed jumbo loans were held by BS?

FRIEDMAN: I don't know.

KREBS: Do you know any of the assets that were included in Maiden lane?

FRIEDMAN: Only from what was in the press.

KREBS: You didn't have any experience with those loans?

FRIEDMAN: No sir.

KREBS: What is "BUC"?

FRIEDMAN: Business unit controller.

NORMAN: So there's a chart similar to this that breaks it down by rating?

FRIEDMAN: There was the underlying data that built up into this, that included rating information.

EXHIBIT 3

KREBS: BS had a rating organization where they would rate securities, is that right?

FRIEDMAN: No, I'm not. I don't think BS rated any securities.

KREBS: Do you know MGIC investment corp?

FRIEDMAN: I've heard of them, yes.

KREBS: You were copied on this document. Do you have a notion why you were copied?

FRIEDMAN: MGIC was counterparty to some transactions that BS did, and as such there were discussions about them at the credit policy committee. The people on the email at the top were members of the committee.

KREBS: Is it CBass or MGIC investment corp that they're referencing?

FRIEDMAN: MGIC and Radion each owned a portion of CBass. It's reasonably complicated.

(The interview took a short break)

NORMAN: You mentioned that your counsel had shown you a less-legible version?

FRIEDMAN: Yes.

NORMAN: What else did you look at?

HARRIS: We're not going to talk about that, we're revoking privilege.

NORMAN: Did you review other documents?

FRIEDMAN: Yes.

NORMAN: Did this refresh your recollection on any particular topic?

HARRIS: I think we can take this up later.

NORMAN: Outside of the presence of counsel?

HARRIS: No.

NORMAN: Taking it in the second part, I'm not asking about any advice, or document, or any particular thing other than any particular documents?

HARRIS: He can answer the question as long as there's no waiving of privilege.

NORMAN: Other than the ML document did you review any documents that refreshed your recollection?

KREBS: What documents did you review in preparation?

FRIEDMAN: Other than ML, the only other document that I saw was the excerpt from the 2007 Annual Report 10-K balance sheet.

NORMAN: Any other documents?

FRIEDMAN: I don't think so.

NORMAN: Did you discuss the testimony anyone else has given to FCIC?

FRIEDMAN: Could you repeat the question?

NORMAN: Have you talked to anyone about anyone else's testimony to the FCIC?

HARRIS: Other than counsel.

FRIEDMAN: No I have not.

NORMAN: Have you talked to anyone else from BS about this investigation?

FRIEDMAN: I don't think so.

KREBS: I want to go over a couple of quotes attributed to you and whether you deny them. *In House of Cards*, you were somewhat critical of Mr. Cayne and you said “I guess I’ve never worked at a real firm,” and that “we never worked for a real board, we worked for Jimmy”. Did you make that quotation?

FRIEDMAN: Probably.

KREBS: Did Bear Stearns not have a real board?

FRIEDMAN: I hope you appreciate the time when I was interviewed. It was at a time after the firm I’d worked at for 27 years, and things were made bigger than they were.

KREBS: I’m going suspend this to go forward. What is your picture of the developments at BS following the S&P release, immediately following that. What happened after August 5th?

FRIEDMAN: Generally at BS?

KREBS: I know you had a \$2.5 billion raise of funds. Walk me up through the end of the year as far as the material facts.

FRIEDMAN: It’s important to look at the context around us. The securities markets were in disarray, the funding markets in general but specifically, the repo markets were in disarray. And you had a time when there was a spotlight on BS as far as the activities of the hedge funds and to a lesser degree, the negative outlook of S&P. And you had the departure of Warren Spector. There was a concerted effort within the firm to reduce market and funding risk, but the market was not particularly receptive to that. There was a particular focus on the fact that we had bought securities, which naturally tend to increase the size of the balance sheet. I wasn’t involved in the company politics. In my world I was focused on the short term and long term financing.

KREBS: Did you suggest to your superiors that BS should be getting rid of its mbs-related inventories and mortgage inventories?

FRIEDMAN: No.

KREBS: Was it done in your presence and by whom?

FRIEDMAN: I was present at discussions of what was being sold and what wasn’t and what was being bought and what wasn’t.

KREBS: What about the recommendation or the opinion shared by your peers at BS, including Tom Marano?

FRIEDMAN: No, I was not generally in those meetings.

KREBS: You said the securities and funding markets are in disarray what did you mean?

FRIEDMAN: Starting in summer 2007 you had lenders generally becoming reluctant to lend to each other. Even big banks were pulling back. It was not uncommon for us to hear from lenders of ours that they’d love to lend to us but that they had to pull back because they had cash falls. There were many anecdotal stories of big banks telling people not to come borrow because they didn’t have the money.

NORMAN: At that point did you discuss utilizing less overnight funding?

FRIEDMAN: Overnight wasn't what we were focused on, we were focused on the fact that long term borrowings became one day shorter. We spent hundreds of hours of man powers to discuss overnight funding. We thought about it in terms of did we have long term funding. We wanted long term funding. Overnight wasn't the issue.

NORMAN: Why wasn't it the issue, if you're worried about funding going away?

FRIEDMAN: You worry about having x amount of assets that need to be funded and you worry about having enough long term funding. Our focus was on raising as much long term funding as we could.

NORMAN: Was there also a focus on extending the \$70 billion of overnight funding, even to 30/60 days?

FRIEDMAN: I don't think we had 70 billion.

EXHIBIT

FRIEDMAN: I accept your number, overnight and open funding.

NORMAN: Anywhere between 60 and 70 billion in overnight funding, was there ever a discussion that if that was 30 or 60 day funding in terms of markets that were disrupt?

FRIEDMAN: We were focused on pushing funding out longer.

NORMAN: Was there any target you were looking for?

FRIEDMAN: As much as possible.

NORMAN: Was there any overnight lending you thought was perfectly acceptable credit risk?

FRIEDMAN: Our process was to go to customers and tell them to tell us what their target rate was. Any price at any rate.

NORMAN: Was it simply that that entire \$60 billion in overnight funding you could not push out any longer?

FRIEDMAN: That's what I'm saying.

KREBS: what happened in November and December of 2007? You got through most of the fall, but you had to write-down the price plus some additional write-downs.

FRIEDMAN: The markets generally got slightly better then got slightly worse. In the world around us there was a fluctuation of urgency. The market never got close to what we'd think of as normal. We were going about our day trying to deal with it.

KREBS: Mr. Cayne stepped down, how did you view that, is the book [*House of Cards*] essentially correct?

FRIEDMAN: By the time he stepped down there had been a story about him smoking pot at a bridge tournament that was picked up and parodied by other publications and on TV. For those of us who had

been there for a long time and had a lot of pride in the firm, it was hard to have your CEO mocked day after day. It was a relief that you didn't have to deal with it.

KREBS: Was it a relief that he left?

FRIEDMAN: Yes.

KREBS: What was your compensation?

FRIEDMAN: I had the same base salary as all managing directors. It was \$200,000 base until 2002 when I received \$250,000. Then I had a cash and stock bonus.

KREBS: Who made the decisions?

FRIEDMAN: The people I worked for, Spector and Overlander, would make a recommendation to the Compensation Committee, which would ultimately come up with a number that was told to me.

KREBS: What was your total compensation in 2006, all together?

FRIEDMAN: \$3 million-ish in cash and noncash.

KREBS: In 2007?

FRIEDMAN: It was in the same neighborhood, I don't remember exactly.

KREBS: Do you know how much Mike Alix made?

FRIEDMAN: No I don't.

KREBS: Do you think he made \$3 million?

FRIEDMAN: I have no idea.

KREBS: How were you informed about the procedures and system for your compensation?

FRIEDMAN: I was called into Warren [Spector], Jeff [Mayer], or Craig [Overlander]'s office and would they say that we think you've done a great job or horrible job.

KREBS: Did anyone talk to you about the pool of fund utilized in connection of bonuses?

FRIEDMAN: Not really.

KREBS: Was it just based on a return in equity?

FRIEDMAN: I don't know.

KREBS: Was there a period of time in the fall and winter 2007 where you were vocal in your belief that BS should raise additional equity?

FRIEDMAN: Yessir.

KREBS: And to whom did you make those statements?

FRIEDMAN: I mentioned it to Mr. Molinaro, Steve Begleiter, Jeff Mayer and Craig Overlander.

KREBS: What type of reaction did you get from them?

FRIEDMAN: The reaction I got was that they understood it and the firm was looking at a lot of options and they were discussing it.

KREBS: Did you hear from Schwartz about it?

FRIEDMAN: I don't think so.

KREBS: What was Peloton Partners?

FRIEDMAN: They were a hedge fund that went out of business in 2008.

KREBS: Do you recall that UBS downgraded or had some downgrades on Alt-A mortgages that you owned?

FRIEDMAN: I don't remember that.

KREBS: Why do you think Thornburg mortgage ran default and was unable to make payments to BS and others?

FRIEDMAN: The securities they owned went down and they couldn't make the margin calls.

KREBS: Do you know the types of securities they had?

FRIEDMAN: A range of non-agency mortgage-backed securities.

KREBS: Did they hold the same range as Peloton?

FRIEDMAN: I don't know for sure.

KREBS: When do you recall Thornburg and Peloton's problems came to the fore?

FRIEDMAN: Maybe late or the middle of February 2008? Peloton was the end of the month, leap day. Thornburg I think was after that but I can't remember.

KREBS: Where were you the week before the 10th, were you in the country?

FRIEDMAN: I think so.

KREBS: What was going on the 4th, 5th, 6th, any signals?

FRIEDMAN: The week before was consistent with the week before that.

KREBS: What happened on the 10th?

FRIEDMAN: On the morning of the 10th we walked in and found that our credit spreads had blown out over night. The credit markets at least were sending a message that BS was going to default.

KREBS: What did you do?

FRIEDMAN: There was nothing we could do persay about that. The market would trade our name as they wanted to trade our name. We talked about what these implications would be.

KREBS: Did you try to call the counterparties and the lenders?

FRIEDMAN: Some of them.

KREBS: Did you personally talk to some?

FRIEDMAN: Some.

KREBS: Who?

FRIEDMAN: I don't know who I talked to on Monday, but during the week I spoke to PIMCO, Citadel, Dwight Asset Management, and I know there were others but I cannot remember them.

KREBS: Who were the principal repo lenders to Bear Stearns, PIMCO, Citadel, Federated, and Fidelity?

FRIEDMAN: RBC was large. We looked at it in different ways because there were large notational amounts like Fidelity, that took agency collateral only. Foreign banks would accept mortgage-backed and Tier 3. The previous [EXHIBIT](#) lists the names at the bottom.

KREBS: RBO pulled out, they wouldn't roll on Monday?

FRIEDMAN: I don't recall.

KREBS: Do you know how much liquidity you had on Monday?

FRIEDMAN: I think we had \$18 billion on Monday.

KREBS: How about Tuesday?

FRIEDMAN: More or less the same.

NORMAN: Was that something you were aware of or just because everyone was focused on it and reported widely?

FRIEDMAN: That week I spoke a lot with Bob Upton and it was one of the topics.

KREBS: Would you normally discuss liquidity pool?

FRIEDMAN: Only because it was a topic at our Global Finance Committee meetings.

KREBS: What are novations?

FRIEDMAN: It's where a trade that a counterparty has with one entity and moves to a different entity.

KREBS: Were there any increases in novations at BS where people were attempting to rid themselves of BS during the week of the 10th?

FRIEDMAN: There were a lot of them, I've never looked to see if there were more that week than the week before.

KREBS: How did novations affect a brokerage firm?

FRIEDMAN: In a normal course they don't, they are simply an operational nuisance that ties up back office. In that week counterparties were using them to get cash out of BS, trying to novate trades to force us to send a check or wire.

KREBS: Are you referring to some type of group action or conspiracy against BS?

FRIEDMAN: No, not one that I'm aware of.

KREBS: How frequently were you in contact with the SEC during this week, or BS?

FRIEDMAN: I don't think I had any communication with them until Thursday night March 13th when the balloon went up.

EXHIBIT

FRIEDMAN: That's a schedule put together by one of the people on the repo desk of lenders who had told us they would be pulling their money.

KREBS: Is it fair to say that Repo rolls in the morning?

FRIEDMAN: Yes.

KREBS: So if it was not rolling on the 14th, it was probably the evening or afternoon of the 13th?

FRIEDMAN: Probably.

KREBS: Does this comport with your understanding of what was going on at the time?

FRIEDMAN: This sounds like the synopsis.

KREBS: Do you recognize the handwriting on this document?

FRIEDMAN: I do not.

KREBS: There's a point here for State Street, does it say week to date run-off?

FRIEDMAN: It seems to.

KREBS: Do you know what it relates to?

FRIEDMAN: I think it's a summary of the losses that week.

KREBS: So \$25 billion had been lost in addition to any novations that had occurred?

FRIEDMAN: I don't think about adding those two together.

KREBS: What happens when a prime brokerage account moves to another firm?

FRIEDMAN: Generally cash balances are moved to the new firm.

KREBS: If a customer has a margin of data are they allowed to lend out the securities that underlie the margin?

FRIEDMAN: Generally, yes.

KREBS: How do you go about settling a moved account?

FRIEDMAN: In the normal course one would move their positions to the new firm and the new firm would pay off the debit balance that the customer owed you. More realistically you'd lend off the money they owe you.

KREBS: If the securities were hypothecated would that create a new step?

FRIEDMAN: It might.

KREBS: What might happen with those?

FRIEDMAN: You may call those loans back.

KREBS: And you do that by giving them money?

FRIEDMAN: Yes.

KREBS: So to do it you reduce the cash available to BS?

FRIEDMAN: Not really, you'd take back the collateral, give the cash to the new dealer who would give you the money and you'd give it to the counterparty. In a normal course it's not a big.

KREBS: In these un-normal times, did it have an impact in the cash balances?

FRIEDMAN: The movement of debits? I don't know that answer.

KREBS: Thursday, what happens?

FRIEDMAN: We were running out of cash.

KREBS: Are you getting reports from your repo desk, asking what's the status is it rolling tomorrow?

FRIEDMAN: Yes.

KREBS: How frequently?

FRIEDMAN: A lot. Ultimately we had a meeting with Upton, Molinaro, and I to go through the end of day cash.

KREBS: Was there a decision reached following that inventory?

FRIEDMAN: The main decision was to call the Fed and SEC and bring them up to speed. I know Mike Alix made one of the calls.

KREBS: Did you make any calls?

FRIEDMAN: No sir.

KREBS: What was the purpose of the calls?

FRIEDMAN: The primary purpose was to alert our primary regulators that we had a funding issue. Afterwards, one of the regulators came on sight and one spent a lot of time with us via conference call. There were a series of conversations.

KREBS: Were you aware that contact was being made with Mr. Dimon at JPMorgan?

FRIEDMAN: I was aware but I read it.

KREBS: Did you come to work on Friday?

FRIEDMAN: I never left.

KREBS: Presumably you knew there were calls to JP Morgan?

FRIEDMAN: Yes. On Thursday night around midnight we met with JP Morgan, presumably set up by a call from Dimon. We were there until quarter of 7 when we learned that a deal had been reached. To my knowledge, the JP Morgan people left BS by midnight.

KREBS: What were you doing Friday?

FRIEDMAN: I was outside Mr. Molinaro's office when the press release came through saying that JP Morgan funding was going to come through. We all celebrated, and I went up to tell the repo desk the good news. For about half an hour it was good news. Our spreads came way in, early indications showed that our stocks were way up. By 9:30 or 10 am it had gone to the other direction. Counterparties refused to deal with us. It all went south very quickly.

KREBS: Did you attend any management meetings in response to that?

FRIEDMAN: I don't think so.

KREBS: What did you do?

FRIEDMAN: At one point I sat at my desk and cried. I tried to figure out what to do. I spent a lot of time at the repo desk and I spent a lot of time with employees who were not there Thursday night and who didn't know what was going on and I was trying to make order out of chaos.

KREBS: Were you called into the office on Saturday and Sunday?

FRIEDMAN: Yes.

KREBS: For what purpose?

FRIEDMAN: A group of us were asked to meet with a series of people from JP Morgan to take them through our balance sheet.

KREBS: Who was your counterpart with JP Morgan at the time? Did they try to match you up department to department?

FRIEDMAN: I met with two people, one was Matt Zaimes and the head of their repo desk whose name I cannot remember.

KREBS: You didn't have a lot to show him did you?

FRIEDMAN: We were done. Actually, we were told to tell them everything. We were showing them our positions and our list of customers. At that point I was trying to focus on showcasing some of the people who worked for me to make sure they got jobs.

KREBS: Were there any loans that didn't have additional calls for margin?

FRIEDMAN: There might have been some, but couldn't have been too many.

KREBS: What happened on Sunday?

FRIEDMAN: Sunday morning we were told to come back for round 2 of the conversations. Our plan was to mix and match a little. Our business lines didn't match up exactly, so we were going to have similar meetings with different counterparties, but they never showed up. When we went home Saturday we went home told that a deal had been struck subject to JP Morgan's board.

KREBS: What were you told Sunday?

FRIEDMAN: A lot of things, but a group of us was there with nothing to do, we were told that JPMorgan's board was in meetings all morning, and had refused to approve it and then that they did approve it.

KREBS: Ultimately what is your knowledge of what transpired? A deal was struck?

FRIEDMAN: Yes.

KREBS: Were you in meetings?

FRIEDMAN: Only after it happened was I informed.

KREBS: Were you informed in person or by telephone?

FRIEDMAN: I don't remember who told me, we were all sort of swirling around.

KREBS: Is it your understanding that Bear shareholders were offered \$2?

FRIEDMAN: Yes.

KREBS: How was it increased to \$10?

FRIEDMAN: There was a concern raised by JPMorgan that if the deal was voted down, their obligation for our financing was on. They came back to the BS board and asked that the deal be reworked, and the quid pro quo for that was the increase in stock price.

KREBS: Did you attend the BS shareholder meeting?

FRIEDMAN: Yes.

KREBS: Did you review the proxy statement generated in context with that meeting?

FRIEDMAN: Probably not.

EXHIBIT

KREBS: Bear Stearns upgrades peer performers, what does that mean?

FRIEDMAN: One of our equity researchers had upgraded peer review, a neutral rating.

KREBS: Do you know what the basis of a March 12, 2008 upgrade could have been?

FRIEDMAN: I have no idea.

EXHIBIT - Bear Stearns memo relating to Thornburg mortgage

KREBS: To the executive committee from you and others. March 12, 2008. What is this?

FRIEDMAN: This was an analysis of the executive committee of the proposal coming out of the Thornburg creditor's committee to forgo and default and be liquidated.

KREBS: What was the plan depicted here in this memoranda?

FRIEDMAN: The plan was that Thornburg would raise a billion dollars of new capital and with that new capital and with the lenders giving time to work out their existing situation, they would ride out the storm and the lenders would not close and suffer losses.

KREBS: Didn't Thornburg subsequently raise \$1 billion in capital?

FRIEDMAN: I know they raised capital, but I don't know how much they raised.

KREBS: Was this transaction conditioned on the acquisition of another \$1 billion in capital?

FRIEDMAN: It was conditioned on a raise in capital, but I don't remember how much.

KREBS: Doesn't it say in the purpose here, "in connection with a \$1 billion plus capital raise?"

FRIEDMAN: Yes sir.

KREBS: Does that refresh your recollection of the size of the capital raise?

FRIEDMAN: I don't recall if they did or didn't. The language "based upon their forbearance..."

KREBS: That would indicate a conditional type transaction?

FRIEDMAN: Yessir.

KREBS: Page 4. Appendix B purports to list the outstanding repo lenders to Thornburg?

FRIEDMAN: That looks right, I agree with that.

KREBS: And Appendix C what is that?

FRIEDMAN: That's the description of rating by collateral type that BS was lending against.

KREBS: Do you remember if at that moment, BS was lending in Thornburg mortgage securities?

FRIEDMAN: I don't know.

EXHIBIT- March 11 email to Jeff, Craig Overlander, Tom Marano re: repo

FRIEDMAN: This is a quick snapshot of the repo activity on March 11.

KREBS: Did you ultimately summarize it in a useful way other than information that continues to leak out?

FRIEDMAN: Probably.

KREBS: What was the situation as your recall it with respect to the repo funding at BS?

FRIEDMAN: We had come into the week over-borrowing. We were eating through the excess, but if people continued to pull their money there was potential for a problem down the road.

KREBS: I understand you started Monday with \$18.1 billion?

FRIEDMAN: In the liquidity pool, that sounds right.

KREBS: I also understand that perhaps on Tuesday the amount was \$11.4, does that sound familiar?

FRIEDMAN: I think so, but I don't know.

KREBS: What happened Wednesday?

FRIEDMAN: Wednesday more lenders called and asked for money back.

EXHIBIT- Email from Paul Friedman to Tom Marano re: good news but lousy timing

KREBS: Can you tell us what the federal program depicted here was?

FRIEDMAN: I've forgotten which acronym the Fed used, but it was one of their lending activities.

NORMAN: It was TLSF.

KREBS: Did anyone attempt to avail themselves of this after learning about it Tuesday?

FRIEDMAN: I said in the email that it wasn't going to be available for another couple of weeks. I don't think we called to make an exception for us.

EXHIBIT- Email from Paul Friedman to Jeff Mayer, et al. re: Non-agency AAA financing

KREBS: What does this relate to?

FRIEDMAN: I think there was a question raised by some portion of the credit committee or management committee, but in the wake of what was going on at Peloton, who else were we lending to.

KREBS: I can't tell from Peloton, but they had a loan amount and a repo amount?

FRIEDMAN: The \$770MM is the amount of market collateral, the \$692 repo collateral.

KREBS: For Thornburg, is \$450mm the market value and \$406mm the value of the loan?

FRIEDMAN: Yessir.

EXHIBIT- Email from Paul Friedman to Tom Marano re: funding

KREBS: I'm going to sandbagged you on the question asked before. When I asked about calling the Fed, I already knew they had. Who led you to believe there was an outside chance it could impact hedges?

FRIEDMAN: This is from August 2007, so you're talking about two separate instances. We had what ultimately became the TSLF or whatever the acronym is. I don't know if we were the first or only ones to pitch it, but through the program, we could add liquidity to the repo markets without taking out risk. We met with a woman at the Fed named Hailey Bowskey. They had seemed reasonably receptive. One of the guys who ran the repo desk for me came up with the idea. It was just us approaching the fed, but we approached on our own.

KREBS: Was it discussed with the SEC at that time?

FRIEDMAN: I don't think so.

KREBS: Did you have meetings apart from this discussion in August, did you meet or have discussions with the FRBNY?

FRIEDMAN: Other than the two or three meetings with Hailey I didn't really meet with them.

NORMAN: Who came up with the idea?

FRIEDMAN: Dave O'Meara and Volpe.

KREBS: And who's Volpe?

FRIEDMAN: One of the senior traders at BS.

EXHIBIT Email from Paul Friedman to Tom Marano re: Executive Committee June 20, 2007

KREBS: What's going on here? Does this relate to the two BSAM hedge funds?

FRIEDMAN: Yes it does. This was became a variation of what we ultimately did, taking down a portion of the lenders and substituting BS.

KREBS: With respect to the High Grade Fund, you just ultimately took the high grade folks out?

FRIEDMAN: Right.

EXHIBIT- Email from Paul Friedman to Tom Marano et al. re: June 24, 2007

FRIEDMAN: This is an email from me to Tom, Jeff and Rich Marin, regarding the takeover of the repo lending to the hedge fund.

KREBS: There's a reference here to Everquest, what was that?

FRIEDMAN: Everquest was a securitization that the hedge funds had done.

KREBS: Have you changed your opinion since you spoke with the author of *House of Cards*?

FRIEDMAN: It never went public so it's somewhat moot, but no.

EXHIBIT- Email from Robert Upton to John Stacconi et al. re: March 21, 2008

KREBS: This is a late document, can you tell me what's going on here?

FRIEDMAN: The email exchange itself is just a request for some more information from the various people involved around the firm.

KREBS: I presume the only reason you were copied on this is because you were in charge of repo at one time.

FRIEDMAN: Yes.

KREBS: What is CT?

FRIEDMAN: Custodial trust.

KREBS: What does that refer to?

FRIEDMAN: That was a small bank subsidy of BS.

KREBS: In connection with the prime brokers accounts, if a prime broker client asked to keep funds in custody, was it a methodology for preventing BS from rehypothecating or using the cash in that customer's account?

FRIEDMAN: For a customer that was lending money, their money was locked up. This did not apply to customers that were borrowing money.

NORMAN: Is Custodial Trust an Irish subsidiary?

FRIEDMAN: No, it's in Princeton NJ.

NORMAN: And did BS have that subsidiary in 2004?

FRIEDMAN: Yes.

EXHIBIT

KREBS: Can you identify this for me?

FRIEDMAN: This is an update of the report shown earlier showing the lending analysis of March 19th.

(The interview took a short brake)

KREBS: Can you give me a view of how the repo market work as you understand it?

FRIEDMAN: That's a fairly large question. It's a market whereby holders of securities finance them with holders of money and where parties that have a need to borrow securities and borrow the securities against a pledge of cash in it's basic sense.

KREBS: What are the alternatives for financing business, alternatives and choices that management has other than repo?

FRIEDMAN: There are things other than repo, stock loans, and securities transactions. Those are the main collateralized borrowings, commercial paper, equity, debt. They are all ways to raise money.

KREBS: BS was able after August 3, 2007 to raise about \$2 million in debt?

FRIEDMAN: That sounds like it's in the neighborhood.

KREBS: Why did they elect to do that rather than expand their repo market?

FRIEDMAN: We were doing both. We were trying to expand our repo borrowing, but were exploring a lot of different alternatives.

KREBS: Is it fair to say that repo borrowing is cheaper than long term borrowing?

FRIEDMAN: No. Shorter term borrowings are cheaper.

KREBS: After the S&P report, did Bear Stearns elect to take the more expensive means of financing?

FRIEDMAN: Yes.

KREBS: Do you recall the January 2008 debt issuance?

FRIEDMAN: There were two issuances, but I don't know the dates. It was part of our desire to be raising money wherever we could. Our unsecured borrowing was getting shorter every day.

KREBS: BS could have also gone to the equity market couldn't they?

FRIEDMAN: They could have.

KREBS: Isn't that the position you indicated to your colleagues?

FRIEDMAN: Yes.

KREBS: Why then did BS increase its use of repo during the time period 2006-2007-2008?

FRIEDMAN: The strategy was to replace the shorter term borrowings (CP) with the longer term repo borrowings.

KREBS: This still was not as expensive as the long term debt markets?

FRIEDMAN: Correct.

KREBS: Did anyone consider the acquisition of equity as opposed to long-term debt and repo financing, after August 2007?

FRIEDMAN: Yes.

KREBS: When?

FRIEDMAN: There were at least 3 cases I was involved in where we had conversations with outside investors who were contemplating putting money into BS.

KREBS: Who were those parties?

FRIEDMAN: KKR, one of the Saudi Arabian princes whose name I've forgotten, and Fortress Investment Group.

KREBS: Why weren't those three possibilities chosen?

FRIEDMAN: I don't know if they weren't. The Saudi pulled away from us, I don't know if KKR and Fortress did.

NORMAN: Whether you increased or stayed steady on the short term repo, isn't it true you could have taken it longer, but there was a decision not to pay to take longer?

FRIEDMAN: That's not true at all. We went to, and I personally went to, a host of lenders and started the conversation with "tell us the rate that you want us to pay long term." The only caveat was not to look too desperate.

KREBS: When did that start?

FRIEDMAN: We started July 2007 and went through Spring 2008.

KREBS: Was the reason you were trying to change that funding the BSAM funds?

FRIEDMAN: No, it was because we had a funding model that said we needed a certain amount of long term debt and we wanted to replenish it.

KREBS: And, alternatively would it have been an option to take your portfolio down and just do less business?

FRIEDMAN: In an orderly market it would have been what you would have done. What made it harder was that a lot of our natural customers were hedge funds and they will only buy securities if you provide financing. You can sell them and reduce the market risk but the funding risk stays the same. You end up lending to hedge funds. If you looked at the funding report from earlier, there were two line items, one was inventory and one was match book. Inventory line constitutes the things we own and matchbook is money we've loaned to a customer. If you sell from inventory with financing, it just moves from one to the other. Our logical customer base was dramatically reduced to where it would only make sense where they were customers that were paying cash for the securities.

KREBS: Caliung, what were they?

FRIEDMAN: They were a French bank.

KREBS: What did you talk to them about?

FRIEDMAN: A billion dollar six month financing line. They said they didn't have any money themselves and were one of several firms we spoke to that hoped we were there to lend them money.

KREBS: What were the proceeds from the repo funding used for at BS?

FRIEDMAN: They were used to fund our own inventory, and to fund loans to customers.

KREBS: Were they used for the acquisition of securities as well?

FRIEDMAN: Sometimes.

KREBS: Particularly in the early years, from 2006-2007?

FRIEDMAN: The acquisition of securities was a small part of our activity.

KREBS: How large was Bear Stearns' securitization and acquisition of mortgage loans?

FRIEDMAN: The mortgage department was in Fixed Income.

KREBS: Fixed Income comprised what proportion of BS revenue in 2006/07?

FRIEDMAN: I don't know.

KREBS: What percentage of revenues was generated by the mortgage department within the fixed income department?

FRIEDMAN: Within fixed income, it was generally one of the larger profit centers.

KREBS: Starting with 2006, one of the larger profit centers for mortgage?

FRIEDMAN: Yes.

KREBS: In 2007?

FRIEDMAN: No, they had a large loss in the fall of 2007.

KREBS: This was the moving of assets onto the book from hedge funds?

FRIEDMAN: Yessir.

EXHIBIT

KREBS: Is it fair to say that the operations committee was interested from time to time in repo?

FRIEDMAN: I think there was a fair amount of discussion about it. The people involved were overlapped from committees. There were discussions at the operations committee about funding.

EXHIBIT- Fixed Income Overview

KREBS: Did you attend the investor day on March 29, 2007?

FRIEDMAN: No I did not.

KREBS: Do you know who Jeff Mayer and Tom Marano are?

FRIEDMAN: Yes.

KREBS: Page 8. Who else was engaged in this market?

FRIEDMAN: Not sure.

KREBS: Did you sit down and have discussions with fellow repo traders or persons running repo desks in the marketplace?

FRIEDMAN: Unfortunately the only time we got to discuss those things was during a credit run (like Peloton, Thornburg).

KREBS: Page 10. Do you know whether BS Residential Mortgage Corporation originated the amount of mortgage loans in 2006 represented here?

FRIEDMAN: I only know if from seeing it here.

KREBS: You had \$69 billion in repo for 2006. Is it your testimony that this repo money was not used to assist in the origination of loans in 2006?

FRIEDMAN: I don't think that the origination coming out of Bear Res was coming out of the repo desk.

KREBS: Were any of the funds from Encore Credit funded by the repo desk?

FRIEDMAN: I don't think so.

KREBS: What was financed from the repo desk in 2006?

FRIEDMAN: A combination of securities and home loans from the trading and government desk, and similar securities we were lending to our customers.

KREBS: What was done with those whole loans?

FRIEDMAN: Generally they were securitized.

KREBS: So from that aspect, the proceeds from repo borrowing were used for loans that were subsequently securitized?

FRIEDMAN: Yes.

KREBS: What else?

FRIEDMAN: They would be used to finance the purchases of the firm and finance the collateral for customers.

KREBS: What types of securities were purchased for the firm using the repo proceeds?

FRIEDMAN: Mortgage-backed securities including RMBS were funded by the repo desk.

KREBS: How were the costs of borrowing allocated?

FRIEDMAN: It depended to some degree on what the product was. With the repo financing for mortgage inventory, the trader who owns the inventory received whatever funds it raised plus their share of the firm's long term debt and the pool of the funding costs.

KREBS: How large was BS's liquidity pool from 2006?

FRIEDMAN: I don't know.

KREBS: We know that at least as of March 4, 2008, when you were visited by the SEC that they passed on your liquidity pool, do you know the size at that junction?

FRIEDMAN: I don't know.

KREBS: Your pool was reduced?

FRIEDMAN: I don't remember the \$11 billion number, but I would agree that it was going down over the course of the week.

NORMAN: In 2005 BS opted into CSE, were you involved in the application process for BS?

FRIEDMAN: No.

NORMAN: Did the SEC examination staff spend time at BS spend time with your group?

FRIEDMAN: I don't think so.

NORMAN: Even prior to the Shift in regulatory regime, the broker-dealer had been regulated by the SEC and subjected to the examination staff. Has the examination staff ever spent time with your group?

FRIEDMAN: I'm not aware of them spending any time with the traders on the desk and myself. I'm not sure if they spent time with people in control roles, those who put reports like this together.

NORMAN: During BS' participation in the CSE program, the leverage of the broker dealer increased two-fold, do you know what lead to that?

FRIEDMAN: I don't know.

NORMAN: Do you recall how the CSE program coming into being?

FRIEDMAN: I remember discussions at the operations committee.

NORMAN: Do you recall discussing the Fed instead of the SEC as supervisor?

FRIEDMAN: It was discussed at some point.

NORMAN: Did the Operations recommend the SEC as supervisor?

FRIEDMAN: Yes. Given the broad range of businesses we were in and the equity and prime brokerage programs, it felt like a better fit for the SEC. They made more sense as a regulator, because they had familiarity. Those were important businesses for us at the SEC. We liked the idea of a regulator who knew our business.

NORMAN: Were there any discussions in the operations committee about the change that BS would have to take to become a member of the SEC program?

FRIEDMAN: I don't remember discussions about any changes, but I remember discussions about how it would work.

NORMAN: You didn't take part in the applications and examinations?

FRIEDMAN: Correct.

NORMAN: Do you remember the flagship examination concerns and the deficiency letter sent to Bear Stearns?

FRIEDMAN: I do not recall.

NORMAN: Any discussions of concerns identified b the SEC?

FRIEDMAN: I don't think so.

NORMAN: You mentioned that you had a few contacts with the SEC. Did you have any other communications with the Fed?

FRIEDMAN: I don't think so.

NORMAN: CFTC?

FRIEDMAN: Don't think so.

NORMAN: FSA?

FRIEDMAN: Nope.

NORMAN: Have you testified before in any context, can you tell us about that?

FRIEDMAN: Yes. From time to time BS was sued by customers, and I often lost the coin toss and became the representative. These were customers who missed margin calls and were liquidated. I was also a witness in a case involving a large foreign exchange.

KREBS: Anything related to the failure of BS?

FRIEDMAN: Nothing.

NORMAN: Have you given any regulators testimony related to failure of BS?

FRIEDMAN: No.

NORMAN: Are you named in any suits related to BS?

FRIEDMAN: I don't think so.

KREBS: Were there any mistakes that were made or changes that could have been made?

FRIEDMAN: I wish I could come up with something, I don't know. I can't come up with anything substantive and looking back at what happened with the other firms, I can't come up with anything that changed their fate.

KREBS: Did the repo funding model have an impact on bear Stearns?

FRIEDMAN: I don't think there was anything wrong with the model, the markets blew up and became dysfunctional.

KREBS: Was there a time with which you believed BS may possibly have avoided a failure?

FRIEDMAN: Yes.

KREBS: When?

FRIEDMAN: Immediately after it happened.

KREBS: What could they have done to avoided the problem?

FRIEDMAN: At the time I believed if we had only raised more equity then rating agencies would not have downgraded us. And then I watched Lehman, whom we had modeled ourselves after and who were

stronger, go under and then Merrill, Morgan Stanley, and Goldman. They all came within an inch of disappearing and I'm a lot less critical of what happened.

KREBS: Being one of five may give you some solace, but doesn't it raise the issue about the industry's business model, since each one imploded around the toxification of the mortgage market and the toxic funding of the repo market?

FRIEDMAN: Morgan Stanley was just barely in the mortgage market, while Merrill had more diversified funding. I can't lay the demise of BS on the funding model or mortgage business.

KREBS: Last question, you spoke of a bank related to BS?

FRIEDMAN: The Custodial Trust Company.

KREBS: Which regulator oversaw that bank?

FRIEDMAN: I know it was FDIC insured, and I believe the Fed as well.

KREBS: What activities did the bank undertake?

FRIEDMAN: It handled trusts and securities, and held pension funds and processed them.

NORMAN: Were there any mistakes from senior management?

FRIEDMAN: The only difference would have been selling the firm altogether. I don't know if it could be categorized as different to save the firm.

NORMAN: Was there a feeling they should have sold the firm?

FRIEDMAN: Just water cooler talk.

KREBS: What in your opinion caused the financial crisis?

FRIEDMAN: Overall? Someone made an analogy to ecoli, in looking at is it possible that the subprime disease could cause all of this and you end up with a combination of that to lend and it put a very large brake on the market.

KREBS: What do you think caused BS to fail?

FRIEDMAN: At the core it was a run on the bank, we ran out of cash. In the broader context, we were a relatively small ship on the terminate seas of financial dislocation.

KREBS: Do you think that if you had a different regulator that it would have made a difference?

FRIEDMAN: I don't see how.

KREBS: Do you think that the close supervision by the Fed or another prudential regulator might have averted this at BS, as opposed to the SEC's interest in protecting the investors and clients of the institutions?

FRIEDMAN: I don't think so, but I don't know. That's a question outside of my skillset.

KREBS: You were in the trenches and you saw what was happening daily. I understand the tsunami and the run on the bank, but had you not been in a position to be there, have you ever thought about that?

FRIEDMAN: I haven't previously. I don't know.

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