

From: Cioffi, Ralph (Exchange)

Sent: Saturday, April 21, 2007 4:22 PM

To: Cummins, Gerald (Exchange); Tannin, Matthew (Exchange); Geissinger, John (Exchange)

Cc: Quental, Greg (Exchange); McGarrigal, Raymond (Exchange)

Subject: RE: equity trades in hgel

Ok let me clear up a couple of points regarding abx trades. Those trades where by we are just shorting ABX we have been doing 2/3 ehgs and 1/3 hgs the reason for that is the leverage ratio between the two and that EHGS has more CDO's exposed to ABS. When we buy ABX we are going to buy it in the exact ratio that that specific ABX tranche is in EHGS and HGS when covering a short or doing a relative value trade ie. we have been buying 06-1 BBB- so we have been allocating that based upon the ratio of 07-1 BBB's that we are short in each fund. As it relates to CDS we will always do those pro-rata because the underlying assets in EHGS and HGS are not overly exposed to Corp. credit. The bottom line is that when we hedge in EHGS and HGS with ABX we do it based upon ABS exposure and every other hedge is pro-rata. As it relates to equities it is true we don't go long equities in EHGS but we can do long short trades or just short trades and those should be all pro-rata.

In the instance where we do trades in SRP and not the other two funds it is because the strategies between the two are in many cases different. We sometimes trade in the same products but on some days we are doing trades in EHGS and HGS and not in SRP and vice versa. Many times it's a function of cash and WC requirements etc. It's hard to use a hard and fast rule because these are not mutual funds and each fund has its own peculiar risk mgmt issues. I wish we could be black and white and allocate everything we do pro-rata but it in the real world of managing hedge funds it's not possible.

As it relates to correlation trades we have used that as a catch all phrase when SRP does a long CDO equity or BBB's for example and short components of the underlying CDO. Those trades are not truly correlation trades they are more relative value short credit spread trades. We have been doing those trades in HGS since we started the fund and the same is true in EHGS.

It sounds to me like we need to be just more diligent in writing up the allocation reasons more clearly. Ill speak to everyone on Monday.

Mr. Ralph Cioffi
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-----Original Message-----

From: Cummins, Gerald (Exchange)

Sent: Friday, April 20, 2007 8:57 PM

To: Tannin, Matthew (Exchange); Geissinger, John (Exchange); Cioffi, Ralph (Exchange)

Cc: Quental, Greg (Exchange); Mcgarrigal, Raymond (Exchange)

Subject: RE: equity trades in hgcl

I wasn't trying to be cavalier, but I was trying to shake you up - in a **friendly** sort of way, you're my favorite PM - as I'm not sure you appreciate the gravity of the situation. So let me try and shake you up some more - in a friendly sort of way.

1) Test period: With regard to trades between SRP and HG/HGEL, we can agree the matrix is in a test period as we can explain to a regulator that these are distinct strategy, which are currently not subject to pro-rata allocations until the new policy for High Grade officially goes into effect. I will talk to Simina about the SRP issue we discussed yesterday - as a refinement of the matrix or just an explanation of the trade may be sufficient. As to trades between HG and HGEL, I think it a stretch to call these two distinct strategies for allocation purposes. Whether every single trader on the HG team knows it, the policy for allocating trades between portfolios in the same strategy has been in effect for three years and we better be prepared to explain our allocations to a regulator.

The issue with respect to equity trades in March and April has nothing to do with refining categories in the matrix. Every equity trade in March was allocated solely to HG. Every equity trade in April was allocated **pro-rata** between the two accounts, except for one trade. In that case, the trade was allocated solely to HGEL and the allocation brought the existing position in HG and the new position in HGEL to a **pro-rata** allocation. Refining the matrix is needed when trades are **not allocated pro-rata**. I was well aware of this when responding the first time and therefore knew that nothing really nefarious was going on. This is not the issue. We had a policy in place that essentially exempted equity allocations from being pro-rata between HG and HGEL in March. In order to change this back to the standard policy, we need a rational **prior** to the change. I checked Ralph's emails and didn't see anything. Changing allocation policy at anytime with no explanation - is no policy at all. Here are the four levels of explanation:

- 1) We change policy with no explanation
- 2) We check-off one extra box on a matrix prior to the change with no rational for the change
- 3) We check-off one extra box on a matrix prior to the change and a rational is communicated to operations risk and the CIO, the minimum required by the policy
- 4) We check-off one extra box on a matrix prior to the change and a rational is communicated to operations risk and the CIO and because these are liquid position, we pro-actively develop a policy on when existing positions in HG will be duplicated in HGEL.

We're at one. We need to be at 4 - beyond the minimum requirements.

2) 'I am confident EVERY trader on our desk FULLY appreciates the importance of the blotter - and the importance of the allocation procedures.'

I'm not so sure and here's why:

When an asked Peter the question: **'Why were these trades allocated to HGEL?'** I stated my understanding of the policy. **We are currently not putting equity in Enhanced leverage.** When I used the word possible answer, I meant logically possible. There are only two possible answers to this query. Peter mis-allocated the trades or I am wrong about the current policy. There may be much sub-detail within each possibility, but any answer needs to fall into one of these two categories. A responsive answer would have been to say 'Jerry - I think you wrong about the policy.' To say the trade was done in the best interest of the fund or is appropriate for the fund is not responsive to this inquiry. Let's hope every trade is appropriate for each and every fund or separate account we manage.

Let's look at a couple more examples of what I would term non-responsive answers:

1) On 4/9/2007, Dhruv Mohindra allocated notional 10,000,000 TABX.07.1.BBB-.40-100 100% to SRP. The allocation reason was that the trade was allocated prorata other than to SRP. Piyush pointed out that you can't allocated 'other than to SRP' and then allocate 100% to SRP. Clearly this is just a mistake. But once pointed out a responsive answer would have been to state the trade was a correlation trade which is only allocated to to SRP or give some other rational. The answer we received was:

'Given our choices from the drop down menu, that is the reason for anything that's 100% SRP. The other two choices don't work as this was not "Working capital limitations" or "Hedge Allocated by % of Exposure"'

Even if "prorata other than SRP" was misinterpreted to mean "allocated to SRP" traders need to think about what they're saying. This says: I'm only going to give you three answers and when I allocate to SRP, the reason is I allocated to SRP.

2) On 4/11/2007, an ABX CDS trade was allocated in ratios of 1-2 HG vs HGEL and a corp cds trade was allocated ~ 1 to 1. The trades are right below each other in the blotter. The reason given in the blotter was that both trades were allocated pro-rata. We can't say two hedging trades were allocated prorata on the very same day and the ratios are 100% different. So Piyush asked Ralph for an explanation. Now I think I could come up with a reasonable explanation for this difference and I'm sure Ralph has a more than a reasonable explanation for this. But it's 8 days later and we have no response. (We sent a second request.) If we wait 8 days to respond, we create a problem where none existed in the first place.

I do believe some of the confusion is caused by lack of training. If BSAM were completely responsive to HG's needs, we'd

have at least one full time person providing training on policies and procedures. Unfortunately we do not have this luxury right now. As such I think all HG PMs and trader need to proactively familiarize themselves with the procedures and ask questions if they do not understand something. It's also not just an issue of training. I'm sure Ray is as busy as anyone on the HG team. Piyush asked him a question and the answer was timely, clear and complete, so I know this is possible to do.

Please do not pass this around to anymore people. I didn't write this because I'm annoyed. I'm really just concerned, but do feel free to call me to discuss.

Jerry

From: Tannin, Matthew (Exchange)

Sent: Friday, April 20, 2007 3:03 PM

To: Cummins, Gerald (Exchange); Mobasheri, Ardavan (Exchange); Hamptian, Peter (Exchange); Geissinger, John

(Exchange); Bhargava, Piyush (Exchange); Cioffi, Ralph (Exchange)
Cc: Quental, Greg (Exchange); MCGarrigal, Raymond (Exchange)
Subject: RE: equity trades in hgel

Cavalier use of email to propose "possible answers" where only one of the many really possible answers is stated so as to make HG traders look stupid is hardly a constructive use of this testing period for our new allocation matrix.

Over the past few weeks I understand there have been a few occasions where the notes the traders have made in the trade blotter have not been consistent with the "categories" in the matrix. I am currently aware of three such situations. In each of these situations I believe the traders have properly allocated the trades to the appropriate strategies - while the way they have described what they have done is confusing - given the words used to describe the categories. While I had some small glimmer of hope that the categories I enumerated would have been perfect the first time out - what I believe I see is that the names of the categories need to be REFINED so as to allow the traders to do what they do - and the notes that they make to be easier to follow, both by Piyush (who is doing a fantastic job as far as I can see) and any other objective party looking at the trade blotter who may not have 3 years experience with the evolution of the High Grade group.

I am confident EVERY trader on our desk FULLY appreciates the importance of the blotter - and the importance of the allocation procedures. I will now speak personally to each one of them again just to make absolutely sure.

I also see that there are some "definitional" changes that should be made to the matrix to better describe the various things we are doing.

Furthermore I believe that there will actually be some changes we are making to "tactical" aspects of the funds in May that will require a change to the matrix (changes, I might add, that are consistent with the procedures we have outlined in our compliance material).

I look forward to moving forward and improving our matrix during the rest of our TRIAL period.

From: Cummins, Gerald (Exchange)
Sent: Friday, April 20, 2007 2:38 PM
To: Mobasher, Ardavan (Exchange); Hamptian, Peter (Exchange); Tannin, Matthew (Exchange); Geissinger, John (Exchange); Bhargava, Piyush (Exchange); Cioffi, Ralph (Exchange)
Subject: RE: equity trades in hgel

You're completely missing the purpose of the allocation procedures. The PPMs for HG, HGEL and SRP allow almost any investment - as such almost any investment could be appropriate. So as not to require explanations for non-prorata allocations across every single sub-set of High Grade portfolios, a matrix was created that showed which security types and/or trading strategies are allowable for each account in the current month. The matrix currently does not allow allocations of equities to HGEL. Hence the inquiry.

Possible answers are: We changed the policy and forgot to tell you on the first of the month as required. We can then decide if forgetting continues to be acceptable for HG. If the policy did change, it raises other issues. High Grade has existing positions. When will you recreate these positions in HGEL? For example, HG is still short Goldman at 200. The stocks at 220. Why wouldn't you short it in HGEL?

Please provide a sensible answer to our inquiry. Thanks.

From: Mobasheri, Ardavan (Exchange)
Sent: Friday, April 20, 2007 1:00 PM
To: Hamptian, Peter (Exchange); Cummins, Gerald (Exchange); Tannin, Matthew (Exchange); Geissinger, John (Exchange); Bhargava, Piyush (Exchange); Cioffi, Ralph (Exchange)
Subject: RE: equity trades in hgel

We are using them as general macro hedges. They are net short individual financial/housing names appropriate for our portfolio.

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From: Hamptian, Peter (Exchange)
Sent: Friday, April 20, 2007 12:49 PM

To: Mobasheri, Ardavan (Exchange)
Subject: FW: equity trades in hgel

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From: Cummins, Gerald (Exchange)
Sent: Friday, April 20, 2007 12:40 PM
To: Tannin, Matthew (Exchange); Hamptian, Peter (Exchange)
Cc: Bhargava, Piyush (Exchange); Geissinger, John (Exchange)
Subject: equity trades in hgel

T/D	buy/Short	Quantity	Cost	Sector	SECURITY
3/23/2007	buy	40,100	(129,122.00)	Option	ACCREDITED HOME LENDERS 10 1/19/08 PUT
4/2/2007	short	(34,000)	2,117,885.38	Stock	MCGRAW-HILL COMPANIES INC
4/2/2007	short	(1,400)	935,396.67	Stock	NVR INC
4/10/2007	short	(73,500)	7,604,641.95	Stock	RETAIL HOLDRS TRUST
4/10/2007	buy	53,000	(7,669,476.30)	Stock	SPDR TRUST SERIES 1
4/11/2007	short	(29,400)	1,678,699.60	Stock	MGIC INVESTMENT CORP
4/12/2007	short	(49,000)	1,720,755.64	Stock	GENERAL ELECTRIC CO
4/12/2007	short	(1,400)	936,660.85	Stock	NVR INC
4/13/2007	short	(29,400)	1,581,604.64	Stock	WACHOVIA CORP
4/16/2007	short	(24,500)	982,824.50	Stock	WASHINGTON MUTUAL INC
4/17/2007	short	(12,000)	810,357.20	Stock	MOODY'S INVESTORS SERV-EX DI
4/18/2007	short	(12,000)	801,800.13	Stock	MOODY'S INVESTORS SERV-EX DI

4/18/2007 buy 13,700 (2,015,852.25) Stock SPDR TRUST SERIES 1

Above are all opening positions in HGEL for equities since 3/1/2007. We are currently not putting equity in Enhanced leverage. Why were these trades allocated to HGEL?