Bear Stearns Notes – 3/6/08 to 3/14/08
Steve Spurry

Thursday March 6

1. J. Giles, K. Silva, and S. Spurry had regularly scheduled update with R. Upton and J. Stacconi (Bear Treasury):

- Bob Upton discussed his concern that, with heightened dislocation in the markets, it felt like they (I interpreted as all market participants) were falling back into a Nov/Dec like liquidity constrained environment. As a result Bear was focused on shrinking balance sheet and increasing the HC liquidity pool.

- CP market was not terribly robust and as a result $1.5 B of their $3.8 CP outstanding was overnight.

- Equity Repo was holding up pretty well. Bear lost a large repo facility, Abbey National, because the institution decided to no longer provide secured funding to the street (Bob noted that this was not Bear specific). Bear had $650 million in equity repos with them, and were able to replace this facility with two new lines—American Beacon and Credit Suisse. Bear had $27 billion in domestic equity repo outstanding with $4.5 billion of this being overnight. This number had been fairly stable for months

- After their earnings they were hoping to be able to increase term CP and term repo

- The firm's last 10 year bond issuance, which went out at Treasury + 362 (or LIBOR + 302) was trading at Treasury + 460 (LIBOR + 390). Because of the significantly wider spread, Bob felt it was unlikely that Bear would do a large deal between then and March 30th. If spreads tightened, they wanted to issue debt in the 2nd quarter. However, at the end of January they had $5 billion Net Cash Capital (they hadn't calculated NCC for Feb month-end yet).

- We also discussed strategic initiatives (see 3/6 write up).

2. Liquidity held steady versus prior day: HC Only = **$17.3 billion** and Total = **$21.4 billion**

Friday March 7

- PC Only Liquidity Pool falls to **$15.8 billion** and Total Liquidity to **$18.3 billion.**

Monday March 10

1. Matt Eichner, Jim Giles, and Steve Spurry have end of day call with Bob Upton (John and Pat?):

- Focus was less on change from Thursday to Friday or Friday to Monday than what they were seeing from Monday going forward (they lost essentially nothing from

Friday to Monday and thus I believe the biggest thing causing the $3 billion drop from Thursday to Friday was Free Credit out).

- Bob Upton explained that <u>hedge funds are starting rumors and creating difficulties</u>. He notes in particular Lek Securities – which we also saw on Bloomberg. I believe he said Lek's name seemed to keep coming up.

- For FI Repo, Equity Repo and Unsecured debt, some lenders signaled their intent to step away. Bob said that some of the guys who were stepping away had been with Bear through thick and thin up until this point.
    - <u>FI Repo</u> desk had $3 billionish pulled, but they were trying to minimize the end of day loss by using excess facilities and seeking replacement funding
    - One <u>Equity Repo</u> lender ($200 million) said they would not roll (out of $2.9 billion total overnight). Another lender of $1 billion said the firm had a credit committee meeting scheduled for the next morning to discuss whether they would roll. A third lender signaled that they would not roll $500 million on Wednesday.
    - Bob also talked about <u>Free Credits</u> from the previous day or two, I think it was that there had been $2.5 billion out over the previous two days (Jim?).

- PC Only Liquidity ended at **$15.8 billion** and Total Liquidity ended at **$18.1 billion**

- Pat Lewis provided a worse case analysis for the next day, which showed the Worse Case Parent Company only liquidity pool falling to $9.21 billion. This did not include any Free Credit outflows (which was viewed more as a short term issue that could be dealt with by pledging customer securities and possibly doing an intra-week C3 calc).

<u>Tuesday March 11</u>

1. PC only liquidity fell to **$9.3 billion** and Total Liquidity fell to **$11.5 billion.**

2. Matt Eichner, Jim Giles, (Kevin Silva?) and Steve Spurry have another end of day call with Bear Treasury:

- <u>Persistent rumors continued.</u> We heard from Bear Treasury as well as the Fed that there were rumors that Bear had failed to deliver customer money (Free Credits), was missing margin calls, failing to deliver cash to settle trades, some banks weren't trading with them, etc. Bob Upton said there was no merit to any of the rumors. He also said that other dealers were moving their marks on trades with Bear and as a result Mike Alix had been working on mark (collateral) disputes all day.

- <u>Drivers of the liquidity reduction</u>:
    - They lost $1.9 billion in equity repo from three counterparties
    - FI Repo lost $350 million in whole loan money it couldn't replace
    - 750 million in CP
    - $690 million in bank loans ($450 of which they said they chose not to roll). They also increased non USD bank loans by $250 million.

- They lost another $2.5 billion in Free Credits (they were re-doing the calculation that night to free up the money for Thursday).
- The C3 deposit for that day went up by $3 billion, but this was largely offset by $2.4 billion in cash they got in from MTM (stock loan/borrow I believe was a big driver.

- Bear was interested in the Fed's term auction facility.

Wednesday March 12

1. I was in NYC at the monthly GS meeting. Goldman's credit department was very focused on Bear and Craig Broderick (CRO) seemed very concerned and upset at things going on in the market (i.e., rumors).

2. In the morning Matt Eichner talks to Bear's Mike Alix:

"I just got a heads up from Bear that they are likely to reach out to some of the other CEOs of dealer firms to reiterate their commitment to work with them to the extent that hedge fund counterparts are looking to assign OTC trades. Some of this occurred already yesterday, particularly with the CSE firms, more at the CRO level. The concern is that if there is a perception that other dealers hesitate to accept assignments that could lead to people looking to assign sooner rather than later, an unhappy event. They wanted to give a heads up just in case we heard murmurs about their reaching out, and just wanted us to know their message."

3. Matt Eicher, Jim Giles, and Kevin Silva have another end of day call with Bear Treasury, and Matt Eichner talks with Mike Alix afterwards:

"They were at $11.3 of excess liquidity yesterday night. (John had predicted an additional $700 mm on the call yesterday but that apparently didn't materialize.)

They lost $70 million of CP and $240 million of bank loans. They picked up $1.4 billion of additional overnight equity repo. They shipped $800 to the finance desk. They had to post an additional $2.2 billion of collateral for stock borrows from yesterday's market gains. And $1.2 billion of free credits left. All of this together reduced liquidity by $3.1 billion, leaving them with $8.2 billion.

Upton believes that they will be able to get $4 - $5 billion tomorrow from 15c3-3 lock-up. He suggests that they will be doing the computation on a frequent basis, as long as there are free credits leaving.

Of significant concern, they heard rumblings late in the day that some of the large money funds (notably Fidelity and Melon) were becoming hesitant and might not roll repo tomorrow. Upton, who had been tied up in meetings all day, was going to speak with them and ascertain what sort of reassurance might be provided. The immediate impact of the money funds leaving would be $1 - $2 billion of additional financing for the repo desk. But the signals would be awful and, as Jim noted, some of these money funds may also be term repo counterparties."

They finish the day with **$8.7 billion in total liquidity**, but expect **$4.1 billion** to be released from the C3 Deposit in the morning.

4. Matt Eichner talks with Mike Alix afterwards:

"heard from Mike Alix..... He said that his reaching out to the dealer community this morning had generally been positively received. He noted, however, that Bear has adopted a pay first and ask questions later approach to disputes on assignments. To wit, they paid $1.1 billion in disputes to 142 counterparties today (all of whom he believes could pay Bear back if that becomes necessary)."

Thursday March 13

1. In the morning Matt Eichner learns from Mike Alix that Alan Schwartz (the CEO) called Tim Geithner on Wednesday night to talk about possible Fed flexibility in the event that some repo counterparties (i.e. the money funds referenced above and below) do indeed pull away . Mike apologized that the SEC was not first notified. Matt recommends that Erik Sirri and others speak with Bear senior management.

2. $3.6 billion in cash is released as a result of the recalculation of the C3 deposit – Bear starts the day with **$12.4 billion in liquidity**.

3. Around 10:00 to 10:30 am, Eric Sirri, Bob Colby, Matt Eichner, Tom McGowan, and Steve Spurry have a call with Bear Stearns senior management – Allan Schwartz and Sam Molinaro (Allan doing most of talking):

- Acknowledged calling Tim Geithner late Wednesday night and apologized for not contacting SEC first (discussed with senior Bear committee before calling Fed? – can't read my notes in terms of which committee).

- Discussed some of the funding they had already rolled (or not) that morning:
  - $2.5 out of $2.9 equity repo rolled
  - Some bank loans in London rolled
  - Had rolled almost all of $2.5 of bank loans in the US (correct? – inconsistent with end of day result)
  - They lost $4 to $4.5 in repo from money funds, about half of which was agency and thus they expected to replace (Fidelity stepped away on non-Agency but rolled its Agency line)

- As of then they hoped to finish the day with $10 to $12 billion in cash.

- Noted the flight of Free Credits ($6.5 to $7.5 recently) as well as people moving entire positions (debits also).

- Allan said the problem was they simply "cannot get in front of the rumors". He said senior people at the other dealers/banks were saying they were open for business with Bear, but that individual desks were starting to refuse the Bear name – both in terms of direct trading and assignments. He also mentioned that every time one hedge fund can't assign away from Bear it tells five others.

- We (Eric Sirri I believe) inquired about any discussions they were having at the moment in terms of capital infusions. Allan said there were no "terribly current discussions". They had hired Lazard to advise them but that was on "slow burn" and that with the time it would take to get that done it wouldn't help (rumors would cause more damage in the meantime).

4. At 3:30 PM the same group as above from the SEC (plus Mike Macchiaroli and I believe Randal Roy) have call with NY Fed – including Tim Geithner and Bob Steel:

- Tim began by saying that Bear was "past the point of no return". He discussed how it was time to start thinking about what was best for the broader market versus what was best for Bear Stearns.
- Matt Eichner asked Tim to expand upon what options he had in mind along these lines. Tim said he was wondering whether Bear needed a bigger push to raise capital, sell assets, and get assets finance on more stable terms – even if it meant "loosing some control over their own fait".
- Someone from the NY Fed asked if there should be a Principals meeting or call the next day. We (I believe Eric) said not yet and that we should have a mid-day conversation.

It sounded as if the NY Fed had more recent information than us, so we reached out to Bear Treasury.

5. We got in contact with John Stacconi. So far they had lost:

- $1.5 billion in free credits
- $300 million of Equity Repo (they had so far rolled $2.5 B of $2.8)
- $0 FI Repo (lost $500 to $1 billion but had replaced it all). Note this is not entirely consistent with the FI repo discussion in #3 above or #7 below.

6. Matt Eichner got a call from Craig Broderick at Goldman Sachs. Goldman was having an impromptu Management Committee meeting in the morning to discus Bear. They were still open for business with Bear across the board, and Craig thought it would stay that way, but it was clear that Bear was in a tough spot (loosing access to CP if not financial institutions). Craig said Bear had been behaving well in making margin payments.

7. We had an end of day call with Bear Treasury and Mike Alix. It was a worse day then they expected. They lost:

- $350 million in Equity Repo
- $1.8 in FI Repo (again inconsistent with 5 above)
- $3 billion in free credits
- $800 to $900 million on derivates collateral (and had post $1.1 B the night before)
- $1 billion US Bank Loans: a $500 million reduction in a secured bank loans with chase and reduction in their with Citi as well
- $400 million London Bank Loans
- $20 million CP

Thus they had lost over $7 billion in liquidity and were down to $5.9 billion in liquidity ($5.1 at the parent and $800 million at BSIL). In addition, they had a bank loan of $1.2 billion with Citi and were on overdraft. Thus they were going to be below $5 billion starting in the morning (latter they said they were only going to have $2 billion – but this apparently had to do with Citi debiting them twice on the $2.4 overdraft – the next day they actually started with cash of $4.8).

In addition, they were facing a number of funding requirements for the next day (e.g., $9 to $10 billion in non-agency collateral to roll, $2.5 in equity repo, $500 million in CP, $2 billion in bank loans). Even if they rolled everything they would still be below $5 billion.

We asked about what they had done (sales etc.) and what they were going to do. They had sold very little up to that point. They said:

- They had compiled a list of collateral that could be sold – although this wouldn't settle same day.
- They were looking at around $10 billion in C3 deposit coming back next week (and would substitute some firm collateral for customer collateral the next day)
- They had $6 billion in bank lines they could draw

Bob (correct?) said if things "miraculously stabilize tomorrow" they would "muddle through".

Thus the only plan they seemed to have was to tap their bank lines the next day (Friday) and/or try to arrange some special same day settlement on some asset sales. Mike Alix asked us about what we could do with them in terms of monetizing the C3 receivable without the time delay (he said that could make the difference).

8. Another Call with NY Fed and US Treasury people – where Mike Macchiaroli says we are thinking about Chapter 11 for the Holding Company.

During this Mike Alix calls Matt Eichner and says they are wondering how they are going to open for business and they were not sure if they could operate normally. Matt passes a note to Mike M and Mike suspends the call with Fed and says wants to talk to Bear again.

9. Another call with a broader group of Bear Stearns folks (Sam, Allan, J Farber, Mike Alix, Upton, etc.)

- They are going to have $2 billion in cash in the morning (again – Citi mistake/issue).
- Thinking about how they are going to open up for business in the morning, They think they either need some sort of liquidity facility or they have to put the HC in bankruptcy and try to operate the subsidiaries. Talks with other firms for capital are too preliminary. They think they need at least a $5 billion liquidity line to open for business.

- This has been a "run on the bank in so many ways". They were taken by surprise by the amount of cash that went out today (much more than they imagined could have gone). They noted how they were getting hammered on OTC marks by dealers and had been posting to try to buy some good will, but that just led to counterparties calling for more collateral.

Mike Alix calls Matt Eichner and tells him they are calling the Fed.

10. They actually open Friday morning with $4.8 billion in cash