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MEMORANDUM FOR THE RECORD

Event: Interview with Michael Alix, former Chief Risk Officer of The Bear Stearns Companies, Inc. ("Bear Stearns", BSC, "the Company" or "the firm")

Type of Event: Group interview

Date/Time of Event: April 8, 2010 at 11 a.m.

Team Leader: Tom Krebs

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

Participants:

Non-Commission
- Michael Alix
- Scott Corrigan, Partner – Wiggin and Dana LLP
- Scott Corrigan, Partner – Wiggin and Dana LLP
- Eric Goldstein, Partner – Paul Weiss
- Jessica Carey, Associate – Paul Weiss
- Matthew Cipolla, Associate – Paul Weiss

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

MFR Prepared by: Desi Duncker

Date of MFR: April 11, 2010

Interview Summary:

Please note the following:

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

Eric Goldstein of Paul Weiss noted that Mr. Alix would be speaking about his experiences at Bear Stearns, not about the Federal Reserve Bank of NY, where he is now employed.

1. Background

Mr. Alix joined Bear Stearns in 1996 as the Head of Credit Risk Management. In 2006, he became the Chief Risk Officer and reported to Bob Steinberg, who was on the Management Committee. At the time, the Executive Committee consisted of Jimmy Cayne, Ace Greenberg, Alan Schwartz, Sam Molinaro and Warren Spector. Prior to 2006, the Credit Risk Department (CRD)'s task was to make sure credit risks were accurately reflected. CRD had about 120 – 130 people, including credit risk analysts. In 2006, CRD was integrated with market risk management and trading risk management (to oversee other risks such as operational risk, etc.)

BSC was a typical large securities firm, with a large mortgage business. He noted that it was a classic 'originate to distribute' model. He noted that Bear Stearns was in the "moving business, not the storage business."

2. BSC's Mortgage Business

At the outset of Mr. Alix's term, BSC did not own any origination firms. But there were correspondents. And there was EMC Mortgage, which providing servicing on loans that were securitized and sold, where BSC retaining servicing. Around '96 or '97, the Company started BearRes in Phoenix, which was a de novo operation to create loans.

Correspondent relationships were basically borrower-lender relationships. There were two models:

i) BSC lent to originators who needed funding, and then securitized the loans. (BSC had SEC shelf registrations for the securitizations.)
ii) BSC bought the loans (which the originators sold to the highest bidder) and packaged them.

3. Risk Management / Third-Party Involvement

This responsibility primarily resided with the business lines, as the risk management infrastructure was not involved when loans came to BSC—this was done by the research and analytical support of the trading desk. It's easy to say ex-post that credit quality deteriorated over time, but there was also a change in the business mix. It was more of a migration from subprime to Alt-A in response to deteriorating quality in the market.

Mr. Alix was not sure if underwriting was contracted out to third parties. But there was a file-checking process, separate from underwriting, that was outsourced. Third parties were used to check the tapes (which came from the originators) from sample loans for accuracy. Mr. Alix notes that this was not his area of expertise and that he was not familiar with the details, as the file-checking process was outside of the risk management function. When pressed on whether or not third parties were responsible here, he noted that there were people at Bear Stearns, within the operations unit of the mortgage business, who were ultimately responsible for verifying the veracity, even if they subcontracted some of the work.

4. Dealings with Originators

Overall assessment was based on credit analysis. The originator would have to take some haircut or equity. There was some spot-checking, but this was not a re-underwriting, but just a compliance check. BearRes was an originator, lending to the ultimate borrower and funded by BSC—but they weren't treated like a third-party.

Mr. Alix stated that there were examples where Bear Stearns would buy loans that had been warehoused, but this wasn't typical. There was no recourse except for Early Payment Defaults, which were kind of a proxy for fraud.

5. Securitization

There was an evolution of the market over time. Subprime had existed for as long as Mr. Alix was at Bear Stearns, and this market had continued to grow. The underwriting standards for subprime did not change significantly. Alt-A was for high-quality borrowers that had an issue preventing them from qualifying for agency mortgages. A large percentage of these were for jumbos, and this market grew quite a bit.

As for the shelf registrations, Mr. Alix noted that he was not the expert on every step in this chain, but that he was happy to tell the FCIC what he knows. According to him, the securities lawyers would be able to tell the FCIC more about them, but shelf registrations are a fast-track

way to issue public securities. Rating agencies were involved because investors required it. Through the process of legal structuring, marketing and trading, loans were reconstituted as securities and sold to investors.

There was typically a waterfall from senior tranches down to the residual, or equity, tranch. Bear Stearns would hold on to the residual, often long enough to get seasoning in these pools so that investor could see some loan performance. EMC would service the loans, although sometimes the originator would continue to service the loans. Starting in August 2007, it became difficult to divest equity tranches, but there was a concentrated effort to manage this risk by hedging, through a short position in triple-B structures that had some positive correlation. (Although Ace Greenberg used to say that "the best hedge is a sale.")

Bear Stearns would sell the risk to the structure. There were a number of ways BSC could manage risk:

i) Outright sale (to investors who understood the risk);
ii) Put on positions to hedge; and
iii) Sell it to a structure that had a set of investors (again with the wherewithal to understand the risk)—this is essentially another version of i).

When asked if equity tranches were used as collateral for repo, Mr. Alix replied "Not to my knowledge."

Mr. Alix noted that, as far as mortgage business positions were concerned, the peak was in 2007—although he also noted that he didn't have a strong recollection. The mix had changed to less subprime, and more Alt-A.

There were lots of investors across different rates/yields/etc.

6. Management Oversight

There was a monthly standing meeting and formal report to the Executive Committee, and Sam Molinaro and Warren Spector met with Mr. Alix more often than that. As for Board involvement, at some point, the Finance & Risk Committee was briefed on the market, credit and operational risks of the mortgage business. In late 2006 or early 2007, Mr. Alix provided the board with the securitization situation overview, and the nature of the risks (including inventory risk and warehousing risk) were described to the Board before the onset of the crisis.

Mr. Alix wasn't involved in Jimmy Cayne's resignation and found out about it when everyone else did. When Alan Schwartz took over, it wasn't really a change internally, as he was already involved. Mr. Schwartz then went on the road to communicate BSC's vision.

Note that the Citic transaction never closed.

Warren Spector was there at the outset of the mortgage business, and was deemed to be the visionary to get it going from simple mortgage securitization to more styles and types of products. This was a significant factor in the rise of the fixed income division.

7. Bear Stearns Asset Management and the Hedge Funds

Warren Spector asked Mr. Alix to look at Bear Stearns Asset Management (BSAM), and he found a risk management team that was competent (and spoke to the on-site risk manager periodically), but portfolio managers were difficult to deal with. Note that risk management for an asset management business is different. For an asset manager, the risk is disclosed to investors. The challenge is to make sure the risk is managed consistently with these disclosures. At BSAM, they didn't understand the reputational risk of losses, even if the risks were disclosed.

In early July 2007, Mr. Alix took over risk management at BSAM. The hedge funds were already gone. The task was to understand BSAM's risks to BSC shareholders. There was also a reputational risk for BSC's repo counterparties, but Mr. Alix didn't become aware of that until after the fact.

Mr. Alix was not aware of the State of Massachusetts action against the BSAM hedge funds, but said that after the inception of the funds, there was a strict restriction on BSC transactions with the hedge funds.

For another levered mortgage fund, BSC did a deep dive, and saw a practical problem for the hedge funds. The redemption right provided to investors had long lock-ups, except for the fact that investors could get out at any time, as long as they took a 5% discount. Mr. Alix became concerned that the portfolios were illiquid and the systems were not set up to let investors out. Ultimately, the funds were gated.

Mr. Alix did not recommend to Mr. Spector that $500 million be invested in the funds. Mr. Alix was told after the fact and did not object to it, but questioned it. These were relatively high-quality securities, but he questioned the commitment amount.

8. Concerns at Bear Stearns

Mr. Alix first became concerned with the future of BSC after the collapse of the hedge funds, given the dislocation in the securitization markets. He was concerned about the Company's ability to generate revenue. BSC's origination process had slowed down.
This was not a solvency concern, as Mr. Alix stated that at no point did he think losses would be greater than BSC's capital. Also, when Merrill Lynch seized collateral from the hedge funds, there was a concern about losing value for the stakeholders of BSAM.

The analysts at Standard & Poor's (S&P) were surprised at the outsized reaction to modest negative action. The S&P action made it more difficult for BSC to operate its business. The reaction within Bear Stearns was to 'batten down the hatches' and manage positions that could not be sold.

The risk inherent in residential mortgages [*as Mr. Alix described in a conference call to investors after S&P's action*] was that credit spreads would widen. To hedge this, BSC used credit derivatives, including the pay-as-you-go swap.

Mr. Alix noted that he was concerned about the monolines, and was worried that they wouldn't be able to perform.

9. After the Hedge Fund Collapse

August 2007 was a difficult month. Liquidity dried up. The demands of repo lenders changed (shorter tenors, higher haircuts), although Mr. Alix noted that that was outside of his risk management function and was more of a CFO/Treasurer discussion. Management was worried about restructuring capital and building the firm for the future.

Risk Management was very skilled at position reporting, aging analysis and price verification. "You don't want to have the wrong marks," as Mr. Alix put it, and the risk management organization was focused on this. Risk Management was never charged with looking forward. However, new people came aboard who were more forward-thinking, and they started to give recommendations.

It's easier to see in hindsight that the problem was with longer assets and shorter liabilities. The funding situation was the cause of the ultimate demise of the firm. Secured funders went from being concerned about loss to just being concerned.

10. SEC

BSC had a regular dialogue with the SEC, and they would typically come up from DC and spend the day at BSC. They met with the SEC in August, after it was leaked that Warren Spector was leaving. At the senior supervisor level, they dealt with the Erik Sirri, Michael Macchiaroli, and Matt Eichner. They worked more closely with the SEC's junior people: Steve Spurry, Michael Hsu, and Jim Giles. On July 28th, the Bear Stearns team met with the SEC and discussed putting in place a variety of hedges.

The Consolidated Supervised Entity (CSE) program allowed the SEC to supervise the holding

company. CSE had competent people and they understood Basel II. It was a different approach, as they came in at a pretty high level. CSE is much maligned. They were disadvantaged, as they had a small swat team of smart people who understood the issues. They were disadvantaged by the fact that they weren't lenders of last resort. CSE people were focused on the right things—they just didn't anticipate the size of the tsunami. They understood how Bear Stearns thought about risk, funding, etc. They also had a view across institutions so they could compare and contrast.

11. Valuing Positions

The principal focus of mortgage risk management was managing the positions. Hedging was on the table to deal with that risk. The hedging strategies were there to bridge the gap from raw material to finished products.

Mr. Alix noted that valuing mortgages is not the risk manager's duty—that falls to the controller. However, price verification, using external data and being thorough and careful, is looked at by risk managers. When BSC got into periods of sudden illiquidity, they moved from a market test to a model test. The modeling expertise was there, and the risk managers were there to make sure that the external inputs were right. Internally, there were a lot of disparate views on value.

Mr. Alix thought BSC's valuations were being conservative, and noted that a lot of people were working long hours on this. He also noted that management wasn't concerned about his view on the outlook—they just wanted him to manage the risks.

The question was how was the firm going to operate in an environment without securitization, which was a significant source of business. (Somewhere between 25 – 50%, although this was for all assets, not just mortgages. But mortgages were the biggest part.)

12. Prime Brokerage Business

Prime brokerage customers keep securities at the firm, and borrow against these securities. This is as opposed to the clearing broker, from which customers rent back-office / processing capacity. (In this case, the brand the ultimate customer sees is that of the fund, but the back-office / processing tasks are performed by the clearing broker.)

Prime brokerage is more of a relationship with an investor using leverage to make its investments. There are lots of transaction needs. The securities are subject to SEC regulations, which allow for rehypothecating. Securities held by margin borrowers can be used to facilitate other customer business. Mr. Alix didn't know if prime brokerage customers were pulling their money, but said Bob Upton, BSC's Treasurer, and Mike Minikes would know. Failure to repay

funds lent to prime brokerage clients is a risk, and there is a risk management function within the prime brokerage business tasked with this.

13. Committee Meetings

Mr. Alix was not sure how he find out about the liquidity problems in January 2008. He stated that it may have been through the Operations Committee. The Operations Committee was a group of control and support managers who meet on a weekly basis.

The Risk Policy Committee meeting cited by the FCIC consisted of the following individuals:

- Steve Begleiter, Head of Strategy, member of the Management Committee
- David Glaser, co-head of Investment Banking
- Bruce Lisman, co-head of Equities
- Jeff Mayer, co-head of Fixed Income
- Steve Meyer, other co-head of Equities
- Craig Overlander, other co-head of Fixed Income
- Kanwardeep Ahluwaliah, head of Market Risk
- James Bell, risk manager who worked for Mr. Ahluwaliah

This Committee discussed liquidity management and talked about the size of the balance sheet. The Committee also discussed ways Custodial Trust Company (CTC) could be used to fund BSC. (CTC was a “non-bank bank.” It was a banking affiliate of Bear Stearns, authorized to conduct certain banking activities.) There was an effort to take into account risk across different asset classes (*i.e.*, margin risk, portfolio risk, etc.)

The Commitment Committee was an Investment Banking Committee, tasked with making decisions about Investment Banking activities. Mr. Alix was simply copied on their correspondence.

14. Final Months of Bear Stearns

In January 2008, the Risk Management function had not changed with managing funding and liquidity risk. By Mr. Alix’s recollection, this month was unremarkable. It went from calm to “all hell breaks loose” in March. In March, the liquidity situation deteriorated, given the market chat about problems at BSC. The market signals were through the CDS market, as CDS spreads were widening. The prime brokerage guys were concerned about the safety of their balances. As for funding, Mr. Alix stated that “that’s conversation for the funding guys.” His understanding was that the liquidity situation was holding up.

The majority of Mr. Alix’s calls were outgoing. He would call and say “We’re here”, and would just want to understand the rumors. Everyone came back and said they weren’t cutting trading

lines with Bear Stearns.

On Wednesday morning (12-Mar-08), there were questions about what the funding would be. Mr. Schwartz went on CNBC. The funding people would give updates by the end of the day. The repos were rolling, so the key was the prime brokerage balances.

The SEC wasn't physically there, but there had previously been perfunctory daily update calls. These calls became less perfunctory as the liquidity situation deteriorated in March. Mr. Alix had a conversation with Sam Molinaro about negative changes in funding that were material, and they decided to call the SEC. Mr. Alix called Matt Eichner and told him that "we think this is serious." Mr. Eichner said he would round up the appropriate people.

JP Morgan demanded $2 billion in collateral to mitigate tri-party repo clearing risk. Mechanically, they would be left holding securities, and were concerned about deterioration in collateral. Even though there was no contractual justification, the demand came to Mr. Alix from the Chief Risk Officer of the JPM's Investment Bank, and Mr. Alix passed it along to Mr. Molinaro. They said no, but Mr. Alix said Mr. Molinaro was the person to speak with about that.

On Thursday (13-Mar-08) evening, they recognized that the deteriorated liquidity position could make it difficult to meet obligations. Rodge Cohen came in, representing Bear Stearns. BSC talked to Timothy Geithner and Jamie Dimon. It was Alan Schwartz's call to proceed.

Mr. Alix's job was to facilitate when the Fed came in, to set up a war room and gather lots of data. Three or four risk management people were there at all times.

On Friday morning at 6:30 or 7am, JPM announced funding, backstopped by the Fed. On Friday, there was overwhelming demand for information, and Mr. Alix helped in facilitating due diligence over the weekend.

BSC had secured funding for 28 days. The ability to stabilize funding could ensure a more orderly process. However, JPM claimed that they didn't have an obligation to fund for 28 days. The issue was resolved over the weekend when the firm was sold.

15. Compensation

The Management & Compensation Committee had the responsibility to set compensation. (This was done through a subcommittee.) Mr. Alix joined this Committee in September 2007. There was a formula for the mix of cash, restricted stock and options. Mr. Alix's base salary was $200,000 until 2006, when it was increased to $250,000, which was the maximum of anyone at Bear Stearns. The bulk of the compensation was discretionary.

Mr. Alix stated that he has had discussions on compensation with a number of people in the industry. The abundance of restricted, unvested stock was of a material benefit to shareholders. He didn't think that there was any evidence that the level of compensation caused excessive risk-taking. But he did think that the level of compensation meant that a robust risk management infrastructure was necessary, *i.e.*, price verification to make sure people aren't paying themselves by marking up positions. Mr. Alix thought that the mix of compensation is fair. The fact that much of the compensation was tied to long-term unvested compensation was a deterrent to people moving to other firms.

Mr. Alix acknowledged that he is not an expert, but believe that the fact that 50% of revenues were paid out in compensation was an artifact of the broker-dealer model. This spiked to 58% in FY'07 because revenues were down and they were worried about people leaving.

16. Other Items

Commercial paper (CP) funding was down and repo was up due to a development in liquidity management strategy. This was a deliberate attempt to change the funding strategy. Growth was funded by CP, and they initially believed they were fine. Bob Upton, to his credit, recognized that this was risky. He devised a strategy to repay CP using more expensive secured funding.

Mr. Alix's media involvement was very infrequent.

Bear Stearns management would meet periodically with rating agencies, about once or twice a year. Bob Upton was the chief liaison with the agencies, who were big on surveys in their templates.

17. Views on Bear Stearns' Demise

Bear Stearns was still entrepreneurial, high-energy, and about trying to figure out how to engage in financial markets for the benefit of shareholders. Under Ace Greenberg, the culture of "trust but verify" persisted. BSC got bigger, but the culture was maintained.

Mr. Alix never imagined that we would see a financial firm's dislocation like this. He was focused on relationships between financial markets and the real economy. He had done work with Gerry Corrigan on CRMPG on this, coming out of the LTCM experience.

Mr. Alix said that what he didn't anticipate was how suddenly liquidity could stop and how difficult it would be to execute plans A, B, or C. He saw material risk to the business model upon the demise of mortgage CDOs. But he never saw the liquidity crisis coming. He figured that the firm would be sold, or other avenues would be explored.

18. Views on the Financial Crisis

There was the belief, led by the credit rating agencies, in housing stock of the US to collateralize securities. The crisis was caused by the shattering of this belief. The fact that the securization model offloaded risk into different parts of the economy brought into question the originate-to-distribute model. The shadow banking system brought leverage.

When pressed about how to fix this, Mr. Alix said that's what he's working on now. More capital requirements / less leverage, more transparency about risk, and more consistency across regulatory regimes. There are balances between capital required and economic activity.

There are reforms coming that will address loan-level detail disclosure.

Mr. Alix said he would fear a world in which the government didn't act. It's unfortunate that there's been so much criticism. The good news is that most of the programs—TALF, CPFF, TAF, guarantee of money funds, etc.—have a sunset.

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

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