Bear Stearns Liquidity Pool Inspection
March 4, 2007
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Overview of the liquidity pool

The liquidity pool is invested primarily invested in cash instruments, primarily money funds. This is because BS can earn better rates through money funds than it can through time deposits. In addition, BS can access overnight liquidity.

BS holds liquidity pools at its three regulated entities (BS&Co, BSSC, and BSIL) and does not include these pools as a part of the parent company liquidity pool. BSSC has lots of trapped cash to handle settlements. Cash trapped at regulated entities is not included in the liquidity pool. If a foreign sub needs cash after the US is closed, the sub can go to Treasury staff in London or Hong Kong. The Treasury staff in London and Hong Kong are not holding company employees, but instead are staff of the UK/Hong Kong broker-dealer. Foreign Treasury staff cannot access the US parent company liquidity pool. In instances where London is short of funding, London typically secures an unsecured overnight bank loan to cover the overnight shortage.

On a daily basis, John Stacconi and Corporate Treasury decide what investment will be held in the liquidity pool. If Corporate Treasury decides to invest in money funds, the Cash and Liquidity Management (CALM) group processes the trade. When Corporate Treasury decides to buy or sell an asset in the liquidity pool, the funding desk writes a ticket, which is then booked into the Electronic Treasury Management System (ETMS). The same process is used if the firm decides to invest in CP, CDs, bank deposits, or any other type of investment.

A rough draft of the liquidity pool investment guidelines were prepared last spring but were not finalized due to the market conditions when the firm decided to go to all cash. A copy of the draft guidelines were obtained onsite. Some changes will be made to the investment guidelines before they are finalized. For example, the liquidity pool will likely be restricted from investing in ABCP over a certain amount. In addition, no money fund will be able to be invested in over 35% ABCP or 5% SIVs. BS may also change the investment policy related to VRDNs.

Overall, the processes relating to the liquidity pool's management is manually intensive and prone to errors. For example, on or about January 29, 2008, BSSC has a $3bn receivable on it books from the parent company (i.e., BSSC thought the parent company owed it $3bn). The parent company paid BSSC $3bn and the end result was parent company liquidity dropping below $5bn (parent company liquidity was $4.8bn), which required notice to the SEC and other regulators. Bob Upton reported the issue to Matt Eichner, who began monitoring the firm's parent company liquidity daily going forward. - from 1/29/08 Ultimately, the BSSC issue was an internal accounting error where BSSC, in fact, owed the parent company $3bn. John Stacconi took responsibility for the error, and the firm committed to several steps to remediate the problem going forward. See Eichner 3/30/2008 email regarding the same and the ongoing monitoring efforts. Stacconi stated had the firm known the liquidity pool would have dropped below $5bn it would not have paid the entire amount, but would have paid an amount that would have dropped the liquidity pool to $5bn.

Funding room daily activities

The day starts at 7:00 am. The team reviews ETMS cash projection management (CPM) to see all projected inflows and outflows for the day. The system receives periodic updates on the status of the maturing CP, investments, CDs, deposits, leveraged loan commitments, customer inflows, and outflows from the brokerage. BS also projects securities settlements for both the firm and customers. The system is currently BS's best tool to provide management a real time update on the status of the firm's liquidity needs for the day.

By 9:30 or 10:00, BS Treasury has an idea of daily settlements. If the firm thinks that it will be short cash, it looks at ways to obtain funding.

If the firm has excess cash at the end of the day, Treasury can either pay down borrowing or keep the cash. Treasury has decided to not pay down the secured funding and instead holds the cash. BS's goal is to move as much cash as possible to the parent company outside of intercompany restraints on regulated entities.

Bear Stearns maintains a $1.5 billion call account at Citibank for late day emergencies. Additionally, BS maintains roughly $3bln of secured funding lines with JP Morgan, Bank of New York and BNP Paribas and committed lines of credit with 15 to 20 banks that amount to roughly $6 to $8 billion. The firm also noted that these unsecured lines are generally available but in a downward market or event, the entire amount of the lines probably won't be available; it would be some amount less. Secured and unsecured lines are not counted as parent company liquidity.

- Emergency Funding Lines

End of the Day Procedures

At the end of the day, the firm will likely either be long or short cash. In the even that the firm is long cash, Treasury will move that money, to the extent possible, to the parent company. The firm prepares an end of the day analysis (or summary) of parent company liquidity, which report is being provided to Matt Eichner as a result of the liquidity pool dropping below $5bn in January 2008 (see discussion above under Overview of liquidity pool). Several factors play into whether Treasury can keep the cash at the parent company.

- Always done?

First, the firm looks at which entity has the cash. If the cash was generated at a regulated entity, the intercompany payable determines how much money can be moved to the parent. For regulatory purposes, a regulated subsidiary cannot owe money to the parent company.

If cash was generated through CP issuance or other debt/note issuance by Treasury, then the parent company simply keeps the cash.

If the firm is short cash at the end of the day, Treasury has several options. The firm can borrow on a secured basis. In addition, the firm can tap unsecured lines, such as from Citibank. Currently, BS has committed lines of credit of $6 to $8 billion in unsecured lines available to the holding company (these are not considered part of the liquidity pool). Use of the cash in the liquidity pool is seen as a last resort.

MIS Systems

? ETMS provides information on BS's opening and closing positions, but does not have real time information. BS's cashier is constantly working to balance the bank draws against CPM (Cash Payment Manager), which ties to the bank statements at the end of the day. Firm noted that ETMS was recently audited by internal audit and the staff requested copies of the audit. The staff did not receive the audits due to Bear Stearn's collapse.

CPM shows high level details that the firm can drill down into the details from the system to specific customer account level details. CPM is used globally and ties to 15c3-3 movements.

Projections

In general, BS tries to put all securities held by subs out on repo in order to fund the business. If a business unit cannot fund a position, they will come to the parent company. According to John Stacconi, for example, there is a one-day lag between when desks buy a security and when those desks are able to repo the security. Bear Stearns is developing a system to better project cash needs in the future, with the goal of being able to predict the next day's draws with a high degree of accuracy. It is anticipated that the new systems will be able to identify collateral that is located in the box so that the firm could finance the position. In addition, Bear Stearns would like to be able to predict cash draws for a few days out, with the understanding that this information will not be as accurate as the predicted draws one day out.

ways to make their liquidity system more sophisticated

In order to have a more sophisticated liquidity management system, the firm must be able to do same day cash projections and same day secured funding of assets. Once that is possible through BS's systems, the firm will create separate a liquidity pool and operating cash.

The projected daily cash draw changes through out the day.

Any difference between the daily projection and the cash balance in CPM at the end of the day is made up through bank loans. As a last resort, the company could sell its money fund investments or accessing the money through customer funds.

To help manage cash needs, the firm uses a daily corporate funding report, which shows short term funding needs. In addition, the firm is creating a calendar of maturities to show maturing debt and paper on a daily basis.

Additionally, Treasury is working with the firm's Global Finance Committee (which has been in place 12 to 16 months) to open up better lines of communication regarding financing needs. Also, the firm's Finance group reconciles liquidity pool activity to the firm's books and records.

Key Controls

The key report that the firm reviews on a daily basis is the daily corporate funding report, which is reviewed by Joe Furlong in corporate treasury and then is sent to John Stacconi, Pat Lewis, and Bob Upton. In addition, George Ilario (business unit control) receives and reviews the report.

The Corporate Funding Report is produced daily, which provides a daily profile of the liquidity pool. In addition, this report contains information on short term (under one year) secured and unsecured funding. The staff obtained a copy of the 3/8/2008 Corporate Funding Report.

BS has established a daily process for monitoring liquidity. On a daily basis, George Ilario reviews the Corporate Funding Report and ties this information to the books and records.

The Global Finance Committee looks regularly at the liquidity pool and reports on the firm's unsecured and secured funding.

There are no Treasury supervisory polices and procedures, and the firm personnel generally rely on the corporate funding report, ETMS, and the end of the day report to manage liquidity held by the parent.

Meeting with George Ilario

Mr. Ilario is the business unit controller. He described the reconciliation process to the firm's books and records.

The majority of the reconciliation happens at month end. Any breaks in the liquidity pool are resolved in two to four days after the end of the month. Mr. Ilario's month-end process reconciles both the balance sheet and profit and loss aspects of the liquidity pool. For the most part, Mr. Ilario's has noted that nominal differences are identified in the estimated interest income and the amount of interest income calculated by the money fund investments. The controller's staff investigates any differences between earned interest and recorded interest. Any differences are captured in the global suspense accounts. Month end reports contain everyday balances and interest rates. Mr. Ilario's group compares the schedule of interest booked to the general ledger. If there are any differences, the team will go back every day and compare the balances to identify the break. On average, the balances reported in the general ledger should be the same as the corporate schedule.

For the reconciliation of the principal amounts, the controller's office conducts a daily reconciliation between the daily corporate funding report from ETMS and a general ledger report for the holding company cash accounts. These two reports are compared for major discrepancies but are not tied exactly.

According to Mr. Ilario, it is possible for there to be breaks in the principle amounts if transactions are booked in the wrong account or if transactions are booked late. These differences would appear in the daily review of the general ledger and the daily corporate funding report. All of these errors are resolved by Mr. Ilario's team.

In order to close the books at month end, the controller's team has a four-day window to identify the appropriate P&L accounts. The firm closes the general ledger sooner than the P&L, which will remain open during the four-day window.