BEAR
STEARNS

MEMORANDUM

Administration

DATE: June 14, 2007

TO: Sam Molinaro CC: Pat Lewis

FROM: Bob Upton, John Stacconi

RE: **Liquidity Pool – Theory and Sizing**

As we migrate the firm's general funding framework to increased use of secured funding (i.e. the secured funding initiative), a pool of liquid assets will be generated and held at the parent company (i.e. the Parent Company Only Liquidity Pool). This memo serves to communicate the mechanics behind the establishment of the liquidity pool, identify the key elements of this pool and enumerate some of the benefits that flow from the overall shift in funding framework and associated development of the PCO Liquidity Pool.

Several components of the firm's established cash capital model drive the issuance of long-term debt without a corresponding need to spend cash. Historically, this cash has been deployed in the normal course of the Corporate Treasury group's funding needs to support the firm's business units. For example, this cash might be used to fund corporate bond inventory, thereby lessening the need to raise commercial paper or some other source of short-term funding to fund this asset. Prospectively, the vast majority of corporate securities inventory will be funded on an ongoing basis in the term and evergreen secured repo markets. As such, the cash capital raised to support a number of potential cash outflows will remain available. This is the cash that will be held in high quality money market investments at The Bear Stearns Companies Inc. This PCO Liquidity Pool will be dynamically sized with regular recalculation. The rationale behind supporting these potential cash outflow items with cash capital is prudent liquidity risk management. The items listed below are primary components (values are as of 4/30/07) and totaled $17.6 billion:

		(Billions)	
1	**Potential Draws on Unfunded Corporate Loan Commitments**	**$5.4**	
2	**Stress Repo Haircut Widening**	**$5.7**	(difference between cash capital haircut and current favorable funding environment repo market haircut)
3	**Excess Derivatives Collateral / Potential**	**$2.0**	
4	**Unsecured L/C's used for Clearinghouse and Exchange Deposits**	**$1.2**	
5	**Reserve Liquidity to support BSFP**	**$0.3**	
6	**Market Stress and Credit Downgrade Derivatives Collateral**	**$0.1**	(only incorporates downgrade)
7	**Target Positive Net Cash Capital**	**$2.0**	
8	**Cash Capital Raised for Internalized Longs**	**$0.9**	(Firm Longs vs. Customer Shorts)
		$17.6	

Once formally adopted, the liquidity pool components would be recalculated monthly with subsequent adjustments made to the then existing pool, as warranted.

From a liquidity risk management perspective, this is consistent with both (1) the firm's current shift in funding framework to reliance principally on secured funding and (2) the approach and relative size of comparable "Holding Company Liquidity Pools" maintained at TBSCI's two independent, institutionally oriented peers (GS and LEH). Beyond the pure consistency notion, the qualitative positives associated with the shift to secured funding and associated maintenance of a holding company liquidity pool includes:

- Lower reliance on confidence sensitive unsecured funding;
- Minimal reliance to draw on committed bank facilities in a stressed liquidity environment;
- No reliance on operational changes in a stressed liquidity environment (collateral always out);
- No signaling risk at exactly the wrong time (i.e. concern about BSC liquidity);
- Infrastructure/mechanism to fund balance sheet growth is in place;
- Further shifts BSC toward "state of the art" liquidity risk management practices.

As a final point, the below table shows the ratio of TBSCI's proposed PCO Liquidity Pool to its total capital, as well as comparable ratios for GS and LEH as of the end of fiscal year 2006 and the first fiscal quarter of 2007. As can be seen below, BSC's position is comparable to these peers under the proposed methodology.

Bear Stearns	1QFY07	FY06
Holding Co. Liquidity Pool (1)	17,580.0	17,580.0
Total Capital (Equity + LTD)	71,768.4	66,699.3
Liquidity Pool / Total Capital	24.5%	26.4%

Goldman Sachs	1QFY07	FY06
Holding Co. Liquidity Pool	55,193.0	51,064.0
Total Capital (Equity + LTD)	188,554.0	172,743.0
Liquidity Pool / Total Capital	29.3%	29.6%

Lehman (2)	1QFY07	FY06
Holding Co. Liquidity Pool	29,800.0	31,400.0
Total Capital (Equity + LTD)	126,756.0	113,247.0
Liquidity Pool / Total Capital	23.5%	27.7%

(1) BSC Parent Company Liquidity Pool data as of 4/30/07.

(2) LEH also holds sizable Liquidity Pools at each regulated B/D.

Please advise us if you would like to meet to review further.