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Wendy Edelberg
Executive Director

August 9, 2010

Via Email & Mail
Mr. Warren Spector
c/o David B. Anders
Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019

Re: Financial Crisis Inquiry Commission Hearing on May 5, 2010

Dear Mr. Spector:

Thank you for testifying on May 5, 2010 in front of the Financial Crisis Inquiry Commission and agreeing to provide additional assistance. Toward that end, please provide written responses to the following additional questions and any additional information by August 23, 2010.[1]

1. During the "run" on Bear Stearns in March 2008:

   a. Was Bear Stearns' OTC derivatives dealing business affected? If so, please describe.

   b. Did potential counterparties refuse to enter into contracts with Bear Stearns? If so, please provide specific examples.

   c. Did existing counterparties try to terminate their contracts with Bear Stearns through novation or other means or did they try to reclaim collateral posted with Bear Stearns? If so, please provide specific examples.

   d. Did Bear Stearns's derivatives business contribute to the "run"? If so, please describe.

[1] The answers you provide to the questions in this letter are a continuation of your testimony and under the same oath you took before testifying on May 5, 2010. Further, please be advised that according to section 1001 of Title 18 of the United States Code, "Whoever, in any matter within the jurisdiction of any department or agency often United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined under this title or imprisoned not more than five years, or both."

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2. At the hearing, Commissioner Keith Hennessey shared his rendition of what happened at Bear Stearns leading up to its collapse, the text of which is located below. Please provide us written responses regarding how the narrative is incomplete and/or incorrect.

"Bear Stearns was not one of the biggest investment banks. Bear Stearns tried to grow quickly to be much bigger. They did this by increasing their leverage to be in the range of 35 to 1, or 40 to 1, compared to tangible common equity. They did this largely by betting on housing-related assets. Their bet was therefore largely concentrated in one sector. Mr. Friedman, you were heavily involved in the implementation of these housing-related investments and this concentration of risk. Like many other banks, Bear Stearns relied on overnight financing, short-term financing for liquidity. Short-term financing is significantly cheaper than long-term financing, allowing Bear to earn higher profits. Short-term financing is also riskier than longer term financing because of counterparty risk. Now, Mr. Molinaro, you led a shift from unsecured commercial paper as a short-term financing mechanism toward secured overnight repurchase agreements. The idea was that the added counterparty risk of relying on overnight financing was outweighed by the reduced risk from having secured financing.

For awhile this strategy, combining extremely high leverage, concentrated bets in the housing market, and reliance on short-term financing worked well. Bear Stearns grew and was profitable. Even after the housing market peaked, Bear continued to make highly leveraged bets on the housing market. They did not de-lever significantly, in effect doubling down on their prior bets. This strategy of big, concentrated bets financed by overnight financing failed even though that overnight financing was secured. While Bear Stearns argued they were profitable and solvent at the time, some investors made judgments that Bear Stearns was a credit risk and refused to roll over repurchase agreements even though those borrowing needs would have been secured.

Whether those judgments were substantiated or not, legitimate or not, a liquidity run began against Bear Stearns. Bear Stearns argues that the liquidity, the tightened liquidity, was system-wide rather than firm-specific, but we know there was something that differentiated Bear Stearns from other similarly situated firms because Bear Stearns failed first. Either Bear Stearns's firm leaders were wrong and the problem was firm-specific credit risk, more than system-wide liquidity risk, or Bear Stearns was more vulnerable than other firms to a system-wide liquidity shock. Whichever reason is true, Bear Stearns was not prepared for a scenario in which they could not get secured overnight financing.

Bear quickly ran out of cash and faced impending liquidation. JPMorgan expressed interest in buying Bear Stearns, but only if the transaction was subsidized. The Fed provided that subsidy, and JPMorgan bought Bear Stearns."

The FCIC appreciates your cooperation in providing the information requested. Please do not hesitate to contact Sarah Knaus at (202) 292-1394 or sknaus@fcic.gov if you have any questions or concerns.

Sincerely,

Wendy Edelberg
Executive Director, Financial Crisis Inquiry Commission

cc: Phil Angelides, Chairman, Financial Crisis Inquiry Commission
Bill Thomas, Chairman, Financial Crisis Inquiry Commission

WACHTELL, LIPTON, ROSEN & KATZ

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September 10, 2010

BY FEDEX & E-MAIL

Wendy Edelberg
Executive Director
Financial Crisis Inquiry Commission
1717 Pennsylvania Avenue, NW
Suite 800
Washington, DC 20006-4614

Dear Ms. Edelberg:

On behalf of Warren Spector, I write in response to your letter dated August 9, 2010, in which you ask Mr. Spector to provide written responses to two additional questions. Mr. Spector is pleased to cooperate. Below we provide Mr. Spector's response to your questions, to the best of his recollection.

QUESTION 1

1. During the "run" on Bear Stearns in March 2008:

   a. Was Bear Stearns' OTC derivatives dealing business affected? If so, please describe.

   b. Did potential counterparties refuse to enter into contracts with Bear Stearns? If so, please provide specific examples.

c. Did existing counterparties try to terminate their contracts with Bear Stearns through novation or other means or did they try to reclaim collateral posted with Bear Stearns? If so, please provide specific examples.

d. Did Bear Stearns's derivatives business contribute to the "run"? If so, please describe.

RESPONSE 1

As Mr. Spector explained to the Commission on May 5, 2010, he left Bear Stearns in August 2007. Prior to his departure, Bear Stearns had never experienced a "run" — indeed, Bear Stearns earned a profit during every quarter in which Mr. Spector was an employee. Because he was not working at Bear Stearns in March 2008, Mr. Spector has no personal knowledge about the topics addressed by this question.

QUESTION 2

2. At the hearing, Commissioner Keith Hennessey shared his rendition of what happened at Bear Stearns leading up to its collapse, the text of which is located below. Please provide us written responses regarding how the narrative is incomplete and/or incorrect.

"Bear Stearns was not one of the biggest investment banks. Bear Stearns tried to grow quickly to be much bigger. They did this by increasing their leverage to be in the range of 35 to 1, or 40 to 1, compare to tangible common equity. They did this largely by betting on housing-related assets. Their bet was therefore largely concentrated in one sector. Mr. Friedman, you were heavily involved in the implementation of these housing-related investments and this concentration of risk. Like many other banks, Bear Stearns relied on overnight financing, short-term financing for liquidity. Short-term financing is significantly cheaper than long-term financing, allowing Bear to earn higher profits. Short-term financing is also riskier than longer term financing because of counterparty risk. Now, Mr. Molinaro, you led a shift from unsecured commercial paper as a short-term financing mechanism toward secured overnight repurchase agreements. The idea was that the added counterparty risk of relying on overnight financing was outweighed by the reduced risk from having secured financing.

For awhile this strategy, combining extremely high leverage, concentrated bets in the housing market, and reliance on short-term financing worked well. Bear Stearns grew and was profitable. Even after the housing market peaked, Bear continued to make highly leveraged bets on the housing market. They did not de-lever significantly, in effect doubling down on their prior bets. This strategy of big, concentrated bets financed by overnight financing failed even though that overnight financing was secured. While Bear Stearns argued they were profitable and solvent at the time, some investors made judgments that Bear Stearns was a credit risk and refused to roll over repurchase agreements even though those borrowing needs would have been secured.

Whether those judgments were substantiated or not, legitimate or not, a liquidity run began against Bear Stearns. Bear Stearns argues that the liquidity, the tightened liquidity, was system-wide rather than firm-specific, but we know there was something that differentiated Bear Stearns from other similarly situated firms because Bear Stearns failed first. Either Bear Stearns's firm leaders were wrong and the problem was firm-specific credit risk, more than system-wide liquidity risk, or Bear Stearns was more vulnerable than other firms to a system-wide liquidity shock. Whichever reason is true, Bears Stearns was not prepared for a scenario in which they could not get secured overnight financing.

Bear quickly ran out of cash and faced impending liquidation. JPMorgan expressed interest in buying Bear Stearns, but only if the transaction was subsidized. The Fed provided that subsidy, and JPMorgan bought Bear Stearns."

RESPONSE 2

Because it is impossible to fully chronicle the rise and fall of a global financial institution in four paragraphs, Mr. Hennessey's narrative is necessarily incomplete in many respects. Accordingly — and because he was not present during, or responsible for, many of the events referenced in his narrative — Mr. Spector cannot adopt Mr. Hennessey's summary in full. In addition, certain statements in the summary are inaccurate. For example:

- Mr. Hennessey's narrative states that Bear Stearns grew by "betting on housing-related assets." The term "betting" is inaccurate. Bear Stearns had been a major dealer in mortgage and mortgage-related securities since the 1980s (holding both long and short positions), and as the mortgage market grew significantly, so too did Bear Stearns' mortgage department.

- Mr. Hennessey writes that Bear Stearns' "bet was therefore largely concentrated in one sector." Again, the term "bet" is inaccurate. In addition, Mr. Spector does not believe that Bear Stearns was overly concentrated in one business line. Rather, throughout his career at the Firm one of the Firm's goals was to diversify its business across a range of different platforms, both domestically and internationally. In fact, the mortgage securities business line decreased as a percentage of the firm's assets during Mr. Spector's time at Bear Stearns.

- Mr. Hennessey describes Bear Stearns' "strategy" as "combining extremely high leverage, concentrated bets in the housing market, and reliance on short-term financing." This description does not accurately reflect the Firm's overall strategic vision during the 24 years Mr. Spector spent working at Bear Stearns.

With respect to the additional topics addressed by Mr. Hennessey — such as reliance on overnight financing, shifts in funding models, the rolling over of repurchase agreements, perceived credit risks, and liquidity problems in March of 2008 — Mr. Spector is not familiar with these issues in sufficient detail to offer an informed critique of Mr. Hennessey's narrative. As noted above, other aspects of Mr. Hennessey's summary may or may not be accurate, but we have limited our comments to those areas that fell within Mr. Spector's areas of responsibility and about which he had personal knowledge.

* * *

We understand that this letter and the information contained herein will be maintained in strict confidence by the Commission and be used solely for purposes of the Commission's inquiry. Accordingly, this letter has been marked "Confidential Treatment Requested by JPMorgan," and we are providing the information herein pursuant to this understanding.

The letter concerns customarily non-public, confidential, and privileged business, commercial, and/or personal information regarding JPMorgan Chase & Co. ("JPMorgan"), and/or its personnel, as well as those with which JPMorgan has done or is doing business. The Confidential Materials are thus not "agency records" within the meaning of the Freedom of Information Act, 5 U.S.C. § 552(b) ("FOIA"), and/or the Privacy Act of 1974, 5 U.S.C. § 552a ("Privacy Act"). Further, the Confidential Materials are exempt from disclosure under various provisions of FOIA; the Privacy Act; the Trade Secrets Act, 18 U.S.C. § 1905; and/or other applicable provisions of law, regulations, and statutes.

Any production of information herein that is subject to a claim of attorney-client privilege, attorney work product, or any other ground upon which production of such documents or information should not be made to the Commission, is inadvertent. JPMorgan requests that any such production in no way prejudice or otherwise constitute a waiver of, or estoppel as to, any claim of privilege, work product, or other ground for withholding production to which JPMorgan would otherwise be entitled. If a claim of inadvertent production is made with respect to information then in the custody of the Commission, JPMorgan requests that the Commission promptly return such information to JPMorgan and not use such information for any purpose.

If any person not a member of the Commission or its staff (including, without limitation, any government employee) should request an opportunity to inspect or copy the letter, or if you or any member of the Commission or its staff contemplates disclosure of the letter or its contents to any other person, JPMorgan requests that the Commission promptly notify Wachtell, Lipton, Rosen & Katz, 51 West 52nd St., New York, NY 10019 (attn: David B. Anders); Paul, Weiss, Rifkind, Wharton & Garrison LLP, 1285 Avenue of the Americas, New York, NY 10019 (attn: Brad S. Karp); and JPMorgan, 270 Park Avenue, New York, NY 10017 (attn: Stephen M. Cutler).

* * *

Mr. Spector would be pleased to continue to assist the Commission. Please do not hesitate to contact us if he can be of further assistance.

Very truly yours,

David B. Anders

Cc: Ms. Sarah Knaus (by e-mail)