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Bear Stearns Asset Management Pricing Committee Minutes 5-29-2007

Gerry Cummins

Jim D'Sidocky

John Geissinger

Sam Turvey

Greg Quental

See next page for additional authors

Author/Creator
Gerry Cummins, Jim D'Sidocky, John Geissinger, Sam Turvey, Greg Quental, Andrew Donnellan, Guri Virdi, Charles Goff, and Mary Kay Scucci

Minutes

BSAM Pricing Committee

5/29/2007
11:00 AM
237Park, High Grade Conference Room, 7^{th} fl.

Attendees – Members of the Pricing Committee that were in attendance included Gerry Cummins, Jim D'Sidocky, John Geissinger and Mary Kay Scucci Sam Turvey. Also in attendance were Greg Quental, Andy Donnellan, BC Guri Virdi and Charles Goff.

1. High Grade Fair Valuations – ABACUS Deals

Discussion Item

- The committee discussed the Ralph Cioffi's (Portfolio Manager) request to fair value four of the ABACUS securities (A1, A2, B6 & AMSS) in lieu of using the dealer marks received. The deals (detailed in the meeting materials) are synthetic CDO-squared securities that are illiquid. Both Lehman Goldman provided April marks for the bonds.
- The portfolio manager briefed the committee on Goldman's approach to valuation of the ABACUS bonds. Per R. Cioffi, Goldman uses an "implied default correlation" model on the underlying securities to value the ABACUS bonds. They (Goldman) had initially been using a 20% default correlation but are now using 30% default correlation between the underlying securities to value the bonds. He indicated that Goldman's 20% correlation equated to 1.0 factor on the AAA-rated securities and the 30% correlation equated to a 0.90 factor on the AAA-rated securities. R. Cioffi also mentioned that in general spreads have widened but have widened even more in the CDO space. He also added that the head of Goldman's CDO division has recently been fired (around the April 30^{th} timeframe)
- The High Grade team's fair valuation of the securities were markedly different (higher) than the dealer marks received. To arrive at their proposed fair valuation, the High Grade team used a proprietary econometric model that calculates expected losses assuming a default correlation among the underlying assets. They ran twelve scenarios and expect a cumulative loss of 21% on the deal (the 21% is a predictive not actual loss). Thus any tranche with an attachment point higher than the expected cumulative loss should be ok. Since the B6 (10-15%) attaches at a point lower than the expected losses it should be priced lower than the higher rated tranches.
- The Portfolio Manager indicated that they do not use "implied correlation" models to value the ABACUS bonds but use a discounted cash flow model where home price appreciation (HPA) and it's historical correlation to loss severity assumptions are primary factors. Employment rate is also a factor in determining loss severity. The discount rates the High Grade team used to arrive at their proposed fair value the ABACUS position were: 125DM for the A1 tranche, 300DM for the A2 tranche, 1250-1500DM for the B tranche and 75DM for the AMSS bond.
- The Pricing Committee inquired as to whether any of the underlying deals have been put on credit watch by the ratings agencies. No deals were on ratings watch (per R Cioffi).
- During the meeting the committee requested and reviewed historical dealer marks provided by Lehman and Goldman, examining pricing levels and trends. It was noted that the decline in the Goldman marks over the February 07 thru April 07 timeframe was directionally as expected given the market trends for deals backed/referencing subprime residential mortgage collateral. The committee also noted the absence of a decline in the Lehman marks given the state of the subprime market.
- Also in reviewing the historical dealer marks for the ABACUS bonds, the committee confirmed the methodology used to value the bonds in prior months – take the average of dealer marks received - noting that there were differences in the two dealer marks. The committee felt that from a process standpoint that we should be consistent in valuing theses positions.
- The committee also discussed the haircuts applied by the dealers to the repoed bonds as a means to gain another view of the inherent credit risk in the underlying securities and as it relates to the marks they provided. The A1,

A2 and B6 bonds are repoed with Lehman; the AMSS bond is currently repoed with Goldman (with a 4.75% haircut). Per R. Cioffi, the A1 bond was just repoed with Lehman at 95 (e.g. 5% haircut). The committee and the High Grade team agreed that the spread should widen on the A1 bond.

- The committee also discuss the ABX indices and their performance noting that the worst vintages were 25-30 bps worse [???]
- Given the detailed review/discussion of the securities, market trends and relevant dealer date, the committee felt the dealer marks received were more indicative of the bonds valuation than the fair valuation proposed.

Resolution

- High Grade team to obtain new April '07 marks from Lehman.
- Use the average of the dealer marks received from Goldman and Lehman (new marks) in lieu of the proposed fair valuations to mark the positions.

2. High Grade Fair Valuations – Other Securities

Discussion Item

- The committee reviewed the remainder of the securities submitted for fair valuation – some received a mark from dealers, some had not.
- Novastar Mezz ABS CDO: CGM marked this bond at 50. Follow-up by the High Grade team with the dealer revealed that the dealer changed its methodology for marking the bond for April marking it at the NAV. It was agreed that marking this bond (new issue CDO) at its NAV was not proper given that it can't be unwound. The Portfolio Manager proposed marking this bond at a discount margin (DM) of 1250 given market spreads on comparable deals.
- Bonds marked by Deutsche Bank: These are highly-rated deals with seasoned collateral and short average life. The portfolio manager felt that the marks received were low and not representative of the true value given nature of the deals. However the committee agreed that the dealer marks were more representative of fair value than the valuations proposed given the current state of the market for deals of these types.
- TAHOMA: No dealer marks were received for these securities. The committee discussed the structural features and collateral backing this deal.
- [Gerry/Guri. I'm not sure of what initiated the discussion of adjusting the price of the Tahoma 2006 1A (AAA & AA and the Tabs 2007-7A A3 bonds ,as I was in/out of the room. Please provide color]

Resolution

- Mark the Novastar bond at 65 as 1250DM used to price the bond is reasonable.
- Use the dealer marks provided by Deutsche in lieu of the proposed fair valuation to price the positions.
- High Grade team to get dealer marks for the Tahoma securities positions presented.

3. High Grade Fair Valuations – BWIC vs. Dealer Marks Analysis

Discussion Item

- The committee discussed the High Grade team's request to use market-wanted in comp to value ABS CDS and ABS CDS Mezz CDO positions. This is believed to get truer prices at where the securities would actually trade as you would get both sides (buy/sell). The average of the bids and offers received would be used to mark the positions with back-up to be provided to Hedge Fund Operations.
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Resolution

- The committee approved the use of market-wanted in comps to mark the ABS CDS, ABS CDS Mezz CDO positions [taking the average of the bid/offer]

4. High Grade Fair Valuations – BOA Deals

Discussion Item

- The committee discussed some of the details of the BOA deal which closed on May 22, 2007. The committee also reviewed the list of securities that went into the deal and the prices

Resolution

- Since the trade closed in May the profit & loss impact from the deal shall also be in May (vs. April).