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FCIC T Krebs interview of Scott Eichel

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United States of America

Financial Crisis Inquiry Commission

INTERVIEW OF

SCOTT EICHEL

Monday, May 3, 2010

***** Confidential *****

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CONFERENCE CALL OPERATOR: You will now be placed into conference.

ERIC: Hello?

MS. SIMHAI: Hi.

MR. KREBS: Hello?

ERIC: Mina?

MR. KREBS: Yes.

MS. SIMHAI: Uh-huh.

MR. KREBS: Mina Simhai, Tom Krebs, Chris Seefer, and Clara Morain.

ERIC: Okay. Hi.

You have Eric and Jessica, and Rebecca Kinburn from Paul Weiss.

Fred Marcusa --

MR. MARCUSA: Hi, Fred Marcusa from Kaye Scholer, representing Scott Eichel.

MR. KREBS: Fred, nice to meet you by phone.

MR. MARCUSA: Very nice to meet you.

ERIC: And Scott is in the room as well.

MR. EICHEL: Hi. How you doing? Scott Eichel.

MR. KREBS: Hey, Scott, how are you?

Have they told you that this interview will be recorded?

MR. EICHEL: Yes, yes, yes.

MR. KREBS: Okay, good.

Now, Scott, we're with the Financial Crisis Inquiry Commission. And it's our job to report to the American people the problems relating to the financial crisis. And we are looking at Bear Stearns, but I would particularly like to take a line of questioning with you today that, it involves Bear Stearns, we have -- we would like to get into it.

We're -- also, I should tell you, at the outset of these proceedings, that under 10 USC 1001, that it is a crime to lie to us -- lie to us in that we are federal agents.

Excuse me, that's 18 USC 1001.

Do you understand that, Scott?

MR. EICHEL: I understand, and hopefully I can help you out.

MR. KREBS: Thank you, Scott.

Would you please kind of give us a thumbnail of your work history at Bear Stearns?

MR. EICHEL: Sure. Going back, I was an intern at Bear Stearns for two summers. And then I started there in the summer of 1997 as something called a "reverse engineer," or basically just a fancy term for an analyst. And I went on the trading desk, non-agency mortgage trading desk, in 1998.

Then I started trading asset-backed securities as well.

I believe I made -- I was named head of credit trading for the mortgage department in 2002 or 2003, I believe.

MR. KREBS: And in that capacity, how many people reported to you as head of credit trading?

MR. EICHEL: Head of credit training, only a couple of traders.

MR. KREBS: Okay.

MR. EICHEL: And then I believe my last job was in December of 2007, where I was named the co-head of the mortgage department.

MR. KREBS: Was there a point in time when you were dealing with the CDO group?

MR. EICHEL: The CDO group is -- you know, they're a banking group, and I'm obviously part of the trading group. I did have people reporting to me who trade CDOs in the secondary market.

MR. KREBS: All right.

MS. SIMHAI: Who was the other co-head of the mortgage department with you?

MR. EICHEL: At the end, Josh Weintraub.

MS. SIMHAI: Okay.

MR. KREBS: Were you involved with the pricing of mortgage-related securities while you were there at Bear Stearns in your latter days?

MR. EICHEL: Just to be clear, like, from the new-issuance side or from just like pricing securities for like month-end valuation?

MR. KREBS: Well, let's try month-end valuation first, and then we'll get to new-issue securities.

MR. EICHEL: In my earlier days, when I was actually a line trader, yes, I would be -- you know, at the end of every month, we'd be responsible for pricing securities.

Later on, I'm not sure if you're familiar, Bear Stearns actually had a pricing group called "Pricing Direct."

MR. KREBS: Uh-huh.

MR. EICHEL: And they handled most of the pricing inquiries.

MR. KREBS: Was that true when you were dealing with non-agency mortgages or is that going back to 1998?

When did that program start?

MR. EICHEL: Oh, that's a good question.

I would say it was more in the later 2000 period. You know, if I had to take a guess, take an educated guess, I would have said probably somewhere around 2005 or maybe early 2006.

MR. KREBS: And in connection with that pricing, would they do the pricing for all the various departments there at Bear Stearns?

MR. EICHEL: The goal -- you know, the goal was to do that. They were I believe -- closer to the end, they were pricing actively for the mortgage department, the corporate department, and treasuries. I'm not sure if they got into munis yet.

MR. KREBS: Were they responsible for the development of pricing models?

MR. EICHEL: You know, probably not.

They would use the models that strategy or research developed.

MR. KREBS: But they, rather than the traders themselves, would go out and price those securities; is that correct?

MR. EICHEL: They would try -- they would try to their best of efforts to price securities. The traders could -- would give them information such as, you know, potentially pricing grids; or if there were hard-to-value securities, then it would fall back into the trader's lap, probably.

MR. SEEFER: Hey, Scott, this is Chris Seefer.

We've heard from some other folks what all the folks would do to value the trading book and to get the marks, was they would simply get information from the five big investment banks, of which you guys were one, and simply use the average to -- you know, if there wasn't -- if you couldn't just look at the exchange and see the daily prices.

Is that something that was going on at Bear, do you know?

MR. EICHEL: Sorry, when you said they would look at the five investment banks, what particular clients are you talking about?

MR. SEEFER: You mean which banks am I talking? You know, Goldman, Morgan, Merrill, you guys, and Lehman.

MR. EICHEL: No, no, no. I apologize, sorry. Not the five investment banks who they would get it from; but I'm saying, who is the end user in your scenario? I'm sorry.

MR. SEEFER: Well, when you guys are marking-to-market your trading book, whether it's -- you know, and for, I guess, all the Level 1 assets, you don’t need to do that because you’ve got -- you know what the price is. You just looked at the market.

But I suppose for Level 2 and 3 assets, you would get, you know, either a bid ask or something from the various broker/dealers to make your mark.

Is that something --

MR. EICHEL: Sorry, you’re talking about -- so, you’re talking about for our marks?

MR. SEEFER: Right, correct, yes. Yes. Sorry.

MR. EICHEL: Okay, I thought you were talking outside marks. Okay, sorry.

Our marks --

MR. KREBS: Well, I think what he was asking was --

MR. SEEFER: So go ahead. Is that how you guys would come up with your marks?

MR. EICHEL: No, no. Our marks would -- you know, our marks, each individual trader is responsible for marking their books.

MR. SEEFER: Okay, and so how would you guys go about marking your books, given the fact that you guys also had this pricing group?

MR. EICHEL: Oh, okay, sorry. The pricing group -- sorry -- is -- the pricing group is an outside vendor for customers, money managers, hedge funds, banks, and insurance companies.

The actual securities that are in ownership of Bear Stearns or, for example, that are on repo have to be priced by, you know, the person whose actually trading book it was in or, for example, on the repo book, it would have to be priced by a trader who had the expertise in that particular area.

MR. SEEFER: And how would the trader go about pricing?

MR. EICHEL: Okay, so, obviously, you know, there -- obviously, what the most important thing would be, any trades that they can relate to in the current marketplace; so from the first, most important thing, a trade in that security or like security. For example, if you had Security 2006-1, the triple-D, that would be great if you could price that first. And then if you couldn't find that in 2006-2 or, you know, the one before, at the end of 2005, you would try to price a like security.

The other way that -- so actual trades that you've done also color in the marketplace from customers from trades they've done. Or there's also, obviously, a broker's broker market, where investment banks are doing trades with each other, so you can get color that way.

And then if, really, you had nothing to that like, at the end of the day, back to I think maybe where you were going before with modeling, you could use your model; that basically if you traded a like security and you know you traded that security to the model, so let's just say, a 6 percent return, then a trader might price a like security to the same scenario, to a 6 percent return, obviously adjusting it for proper risk reward and leverage of that particular security.

MR. SEEFER: Okay, thank you.

Now, here come -- here comes the memory-test question: Do you recall -- and focusing on 2007, and, in particular, before the two hedge funds blew up in July, do you recall if the marks were going down in the first half of '07?

ERIC: This is Eric.

Tom, when we set this up, this was a ten-minute call focused on the subjects of the questions that were asked about -- that were asked for Tom Marano; and we were then told by Mina the next day that we wanted to have them asked of Scott.

We are -- this is a very, very different set of questions that, frankly, we've not talked to Scott about.

And, again, we're happy to make Scott

available, but we were specifically told the purpose of this call and this interview was to address those subjects.

MR. KREBS: We will move to those subjects. But if Scott remembers this -- this is just probably the last question we have in this area.

ERIC: Okay, yes, I was giving you latitude because I thought you were moving on.

MR. KREBS: Yes.

ERIC: But as it's getting more to a memory test, you know, again, it's just not what we were told the call was about.

But, Scott, if you still have the question, if you know what that was, if you know the answer for sure, go ahead.

MR. EICHEL: Sorry, can you just repeat the question? I'm sorry.

MR. SEEFER: Sure.

In terms of the marks on the trading book or on the collateral securing the repos, do you recall if the values were going down in the first half of '07, before the hedge funds blew up in July?

MR. EICHEL: I believe, if I recall, there was -- there was two periods. There was a down period from January '07 to probably about March. And then there was an upward period, from -- to about the hedge-fund time, probably March or April for the hedge-fund time.

MR. SEEFER: Okay, okay. I'm happy to move on since you guys didn't have time to talk to Scott about this. We might have a couple more questions on this topic.

So -- and I apologize, you guys. This is Chris Seefer talking. I wasn't in on your earlier conversation, so I didn't mean to sandbag you or anything.

In terms -- so tell me if this is correct, I believe that the topic of the conversation or the interview was going to be the --

MR. KREBS: John Paulson.

MR. SEEFER: -- right, the interaction with Mr. Paulson and his -- or with Paulson's people on the --

ERIC: That's our understanding as well.

MR. SEEFER: Right, okay, so let's go there.

ERIC: Let's go over there.

MR. SEEFER: And I'll tell you we know what we -- you know, some of the things we've seen, that you may have seen are, you know, this excerpt from *The Daily Beast* that, of course, says that you, Scott, you know, had, I think three different meetings with these folks.

So I guess the first question is, can you just generally describe, you know, when you first had meetings with these folks and what they proposed? And if you've seen *The Daily Beast* stuff, tell me if there's anything in there that's inaccurate.

MR. EICHEL: I'm not sure it was *The Daily Beast.*

MR. SEEFER: It's excerpts from "*The Greatest Trade Ever.*" So I guess…

MR. EICHEL: Yes, I mean, I guess we could refer to the book or whatever.

Yes, we had -- we did -- I do recall, we did have three meetings with John Paulson.

The first one, I think, was kind of an introductory meeting, to kind of, you know, hear what he was all about, the trades he'd like to put on; and, you know, probably our thoughts on the market -- just general market color and so on.

MR. SEEFER: Uh-huh.

MR. EICHEL: The second meeting was -- you know, we're obviously more familiar with each other, and it was exploring, you know, different ways to do business together.

And then a third meeting was more of a

challenging meeting. I believe he wanted one of our heads of research or strategy there and, you know, was more of a count -- a point-counterpoint type of meeting, you know, discussing the merits of different trades and so on.

MS. SIMHAI: About when did these meetings occur?

MR. EICHEL: You know, I want to say throughout 2006. The first meeting could have been early 2006, maybe late '05.

The second meeting, towards the end of '06 -- like probably, you know, we'll call it --

MR. MARCUSA: If you're not sure, Scott, don't guess.

MR. EICHEL: Yes, I'm not -- I'm not going to -- I'm not really that -- my memory is not that great on exactly when the times were.

MS. SIMHAI: Okay. Is it safe to say '06, or you're not -- you're just really not sure?

MR. EICHEL: You know, I'm not really sure.

I feel that they're in '06, but could have one have touched '05 and one touched '07? Maybe.

MS. SIMHAI: Okay.

MR. KREBS: And the third meeting?

MR. EICHEL: I'm sorry, that was the -- the third meeting was the point-counterpoint meeting, sorry.

MR. SEEFER: Okay, I take it, at one of these meetings -- or tell me, at any of these meetings, you know, does -- do you or someone from Bear Stearns say, "We're not interested in doing these kind of deals?

MR. EICHEL: Oh. Okay, sorry. I think in the book it's referring to -- there was a -- in the second meeting we had, through part of the meeting, you know, Paulson -- I don't think it was a secret to anybody -- that he was looking to, you know, place a short on the housing market or the subprime market.

So he was interested in doing a CDO where he would take, you know, synthetic CDOs; so if you sold it right, you'd create a bunch of longs and shorts. If you did deals, you would have a bunch of longs and shorts. And he was interested in taking the entire short side of the trade.

So we discussed with him, you know, kind of what that would take, meaning, would he manage the deal, would he take a slice of long risk in the detail, and so on. Different, you know, questions you would ask someone if you were going to do a CDO with them.

MR. SEEFER: Right, and understanding that that's how he wanted to structure the synthetic CDO -- I mean, it's at least reported in the book that -- and it identifies you as being, you know -- I guess, the word they use was “wary” of that trade, and that you were worried that he would want especially ugly mortgages for the CDOs, like a bettor asking a football owner to bench a star quarterback to improve the odds of his wager against the team. Either way, he felt it would look improper.

I mean, are those -- are those accurate?

I assume you’ve read the book. I mean, are the descriptions in the book about your reaction to these proposed deals accurate?

MR. EICHEL: Yes. I didn’t -- I have not read the book.

MR. KREBS: Oh.

MR. EICHEL: I’ve seen -- I did see these quotes.

The -- so -- okay, so just to go back. So, I had a -- so, we turned down the deal, right. And the point was -- the first part of your question was, we -- you know, he left us with the impression of -- because of previous, you know, interactions with them, that they would either want our help to select the worst possible deals, or that I just had the impression that he would select the worst possible deals.

And, you know, for us, you know, just to give you -- I'm sure this is redundant, so I apologize if it is; but, you know, if you look at the housing market since, you know, 1933 to 2006 -- late '06 -- you know, '07, it only went one direction. And if you look at the CMO market, it went -- you know, it was a very, you know, profitable market for, you know, two generations to be on the long side of the market.

So for me, for our business, you know, when we went into a trade, we hopefully had the intent of, you know, when we would do a deal, that we believe our business was built around the long side of the marketplace.

And usually, when you do a CDO, there are three counterparties. And the three counterparties are: One, you being the issuer; two, the CDO manager; and three, the end buyer, because, you know, the customer's buying it.

If you look at that and look at where their you know, basically intents or interests are aligned for the deal to do well. Everybody hopes the deal does well.

In this case, they're adding a fourth party, which was Paulson, whose intent that he wants to initiate a deal to maximize the deal doing poorly. And so, therefore, I just, for me, for our business standards, you know, for our reputation, I just didn't feel that it made sense to do this deal.

MR. KREBS: Okay, and did you take the proposal up to somebody else within Bear? Or do you just reject it out of hand at, it sounds like, meeting number two?

MR. EICHEL: I rejected it out of hand just after -- after meeting number two.

You know, we walked back -- his office wasn't that far from us. It was somewhere on Madison Avenue. So we walked back ten blocks, we went upstairs, and the salesperson and the banker, you know, asked me what do I think, "Is there something to do here?" And I just simply, you know, *[unintelligible]* saying, kind of in the words that Phil used for you guys, that we're not going to do it.

MR. SEEFER: Okay, and when you say "we" and you're talking about the other two folks, who are they?

MR. EICHEL: I believe -- you know, I believe it was Joe Evanchick and Jeff Hingst.

MR. KREBS: Is that "Hanks"?

MR. EICHEL: Hingst, H-I-N-G-S-T.

I just want to clarify something.

MR. KREBS: Sure.

MR. EICHEL: You know, obviously, on any

synthetic transaction, there's the long and the short. So we did do some synthetic deals where there was obviously a short side that was created.

And just to be clear, the reason why we're comfortable with that is because the CDO manager always picks those assets, and with the intent that they're going to perform as best as they possibly can.

In this particular transaction, once again, is that the impression that I had that, you know, Paulson would be selecting the assets to perform as poorly as they can. So that's, hence, why it didn't make sense.

MR. SEEFER: So was there any discussion about there being the, quote, unquote, CDO manager or portfolio selection agent other than Paulson, or in addition to Paulson?

MR. EICHEL: You know, we just -- it never got that far. The idea was brought up and, like I said, it was readily dismissed.

MR. SEEFER: Okay, now, was the -- you mentioned you rejected it out of hand in meeting number two after walking back to the office.

Was it discussed with anybody else at Bear Stearns who agreed that it should be rejected?

MR. EICHEL: You know, the potential -- I'm trying to think.

Potentially, you know, a guy who is my -- you know, kind of my second-in-command, we might have -- I think we might have talked about it on the way back to the office and, you know, both of us agreed.

MR. SEEFER: And who was the second-in-command?

MR. EICHEL: Adam Siegel.

MR. SEEFER: Okay, did you ever talk to a guy named Ira Wagner about it?

MR. EICHEL: You know, it was funny, I know, when you just asked before, Joe Evanchick was Ira's main banker. I don't believe -- I couldn't recall, when we were just talking about it, if Ira was in the actual -- the second meeting. So I don't believe I did. I just believe we dismissed it.

MR. SEEFER: Okay. Perhaps Joe did, since Joe --

MR. EICHEL: Joe might have talked to Ira about it.

MR. SEEFER: -- worked with him.

MR. EICHEL: I'm sure he would have.

MR. SEEFER: Okay, okay. And, I take it, meeting number three didn't have anything to do with these kinds of synthetic CDO deals?

MR. EICHEL: Yes. No, it was strictly about the subprime market.

MR. SEEFER: Okay.

MR. KREBS: Did Bear typically do synthetic CDO deals? I thought there was a bias against those at Bear.

MR. EICHEL: There -- I think, in general, there wasn't a –- you know, personally, there wasn't a love for, you know, what -- it just wasn't our -- you know, our core business practice.

You know, the deals we did, whether they were synthetic or cash deals, we tended to -- like we talked about before, we wanted, you know, long-term success. So we tended to stay with the same CDO managers, you know, kind of repeat issuers. We tried to target a deal a quarter.

But I think if you ask people about Bear Stearns, I don't think you would -- you know, they would characterize us as a CD -- an ABS CDO, you know, machine or anything close to that.

MR. SEEFER: Did you ever use ACA as a collateral manager?

MR. EICHEL: Sure, we did do deals with ACA.

MR. SEEFER: Do you remember who you dealt with there in terms of individuals?

MR. EICHEL: Sure. Laura Schwartz was the --

she was the, you know, lead person we dealt with.

And then on the -- and then, obviously, we dealt with her –- her group on a day-to-day basis.

MR. SEEFER: Okay.

MR. KREBS: Did you take notes of any kind during this second meeting?

MR. EICHEL: You know, I did not.

MR. SEEFER: Do you recall if any notes were taken when any of -- you were there with a couple of other guys. Were they taking notes, do you recall?

MR. EICHEL: Yes, you know, I don't –- I don't think so.

MR. SEEFER: And, you know, other obvious questions, when you get back to the office, do you type up an e-mail, saying, "Hey, we had this meeting, and I rejected it out of hand," blah, blah, blah? I mean, is there -- if there's any documentation, we may ask the folks at JPMorgan to produce it.

MR. EICHEL: Yes, I don't -- I mean, I don't believe so. I mean, it was -- just to be clear, you know, it was kind of like, I got back to my desk, I was going to the bathroom, and I remember the two guys came up to me and just said, "What do we want to do?," and that was it. I think it was a very open and shut thing.

MR. KREBS: What I'd like to get to is, what precisely was said to you about the method for the selection of the assets to be contained in the proposed CDO?

MR. EICHEL: I'm sorry, it -- I'm sorry?

MR. KREBS: What specifically was said to you about the method for selecting the assets to be contained in the synthetic CDO under the Paulson and Company proposal?

MR. EICHEL: Sorry. You know, again, nothing that I can recall was selected about how they would do it. It was just, you know, call it trader's intuition or impression that I was left with.

MR. KREBS: Well, if you were only given an impression, why did you reject the deal?

MR. EICHEL: Well, just, like I told you before, the fact that someone on the short side of the trade was going to select the assets, one would think -- you know, just generally think, they would want to select the worst assets.

MS. SIMHAI: So did Paulson when he was coming to you with this proposal, did he -- he told you that they would like to select the assets that would go into the synthetic CDO? Or you were just -- it was just kind of danced around? He didn't quite say it, but that was the impression you were left with?

MR. EICHEL: I think it was, as the way you put it, the second one. It was -- you know, it wasn't -- there wasn't anything clear-cut about it.

MR. KREBS: Was anything said about the person who would acquire the equity tranche in this proposal, or was a discussion held about that?

MR. EICHEL: I believe, you know, we asked him if he would take certain slices of risk, and I believe -- you know, I think it was, you know, just a -- you know, I didn't get a straight answer, either, there.

MR. SEEFER: I think it was reported in the book that Pellegrini said that they would be willing to do that.

Does that jog any memory bells?

MR. EICHEL: You know, I think why -- you know, why I didn't get a straight answer, because I think it was one of those answers where, "Yes, show it to us. If it makes sense, we would buy it." But that's, you know, not a "yes" or a "no."

MR. SEEFER: I guess that's one thing I forgot to ask, who were the folks from Paulson that were in the meetings with you, or at least in meeting number two?

MR. EICHEL: Sure. John Paulson, Paolo Pellegrini are definitely the two I can remember.

I can't remember -- potentially, a Brad

Rosenberg was there, and a gentleman named Sihan, who I will not attempt to mispronounce his last name.

MR. SEEFER: Okay, so four folks from Paulson?

MR. EICHEL: I believe so.

MR. SEEFER: Okay.

MS. SIMHAI: Was it -- was this the only occasion where you were approached by a short seller to talk to you about structuring a synthetic CDO?

MR. EICHEL: No.

MS. SIMHAI: What was it about this interaction that -- you know, was this different than how it usually went down?

MR. EICHEL: No. I believe, just to be clear, we were very consistent. I believe I turned down every short-seller to do a deal.

MR. SEEFER: So who else --

MR. KREBS: Who else came to you?

MR. EICHEL: I believe, before Paulson, Morgan Stanley Prop.

MR. KREBS: Anyone else?

MR. EICHEL: I believe we potentially had conversations with Magnetar. But I think it became apparent at the time where our CDO bankers just knew that was -- this was not our franchise. We were not going to do this.

MR. SEEFER: All right, well, Mr. Eichel, thank you very much. We appreciate your time.

I don't think we have any other questions?

ERIC: Okay, Tom, would it be possible for you to give us a copy of the tape?

MR. KREBS: To do what?

ERIC: That would be great. I appreciate it.

MS. SIMHAI: Oh, sorry, he was --

MR. KREBS: Whoa, whoa, whoa, wait.

What was it you just asked? I didn't hear you.

ERIC: Oh, I asked if it would be possible to get a copy of the tape.

MR. MARCUSA: Of the recording tape.

MR. KREBS: Let us check. Let us check and see what the official word --

MR. SEEFER: Situation is here. If they have no problem with it, we have no problem with it. We'll check and get back to you.

ERIC: I appreciate it.

Thanks so much.

MR. KREBS: Okay. You got it.

MS. SIMHAI: Thanks.

ERIC: Thank you.

MR. SEEFER: Thank you, everybody. Good-bye.

MS. SIMHAI: Bye. Okay, that's the end of the interview.

(End of interview with Scott Eichel)

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