

# J P MORGAN CHASE & CO

## FORM 8-K (Current report filing)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**FORM 8-K**

**CURRENT REPORT**  
Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

Date of report (Date of earliest event reported): April 16, 2008

**JPMORGAN CHASE & CO.**

(Exact Name of Registrant as Specified in Charter)

**DELAWARE**  
(State or Other Jurisdiction of Incorporation)

001-05805  
(Commission File Number)

13-2624428  
(IRS Employer Identification No.)

270 Park Avenue,  
New York, NY  
(Address of Principal Executive Offices)

10017  
(Zip Code)

Registrant's telephone number, including area code: (212) 270-6000

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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## Item 8.01. Other Events

On March 16, 2008, JPMorgan Chase & Co. ("JPMorgan Chase" or the "Firm") entered into an Agreement and Plan of Merger with The Bear Stearns Companies Inc. ("BSC"), dated March 16, 2008, as amended March 24, 2008. Certain financial information for BSC and pro forma combined financial information are attached as Exhibits hereto.

## Forward-Looking Statements

This filing contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements include, but are not limited to, statements about the benefits of the merger between JPMorgan Chase and BSC, including future financial and operating results, the combined company's plans, objectives, expectations and intentions and other statements that are not historical facts. Such statements are based upon the current beliefs and expectations of JPMorgan Chase's management and are subject to significant risks and uncertainties. Actual results may differ from those set forth in the forward-looking statements.

The following factors, among others, could cause actual results to differ from those set forth in the forward-looking statements: the ability to obtain governmental and self-regulatory organization approvals of the merger on the proposed terms and schedule, and any changes to regulatory agencies' outlook on, responses to and actions and commitments taken in connection with the merger and the agreements and arrangements related thereto; the extent and duration of continued economic and market disruptions; adverse developments in the business and operations of BSC, including the loss of client, employee, counterparty and other business relationships; the failure of BSC stockholders to approve the merger; the risk that the businesses will not be integrated successfully; the risk that the cost savings and any other synergies from the merger may not be fully realized or may take longer to realize than expected; disruption from the merger making it more difficult to maintain business and operational relationships; increased competition and its effect on pricing, spending, third-party relationships and revenues; the risk of new and changing regulation in the U.S. and internationally and the exposure to litigation and/or regulatory actions. Additional factors that could cause JPMorgan Chase's results to differ materially from those described in the forward-looking statements can be found in the firm's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission and available at the Securities and Exchange Commission's Internet site (<http://www.sec.gov>).

## Item 9.01. Financial Statements and Exhibits

### (d) Exhibits

Exhibits 99.1, 99.2, 99.4, 99.5 and 99.6 shall not be deemed filed with respect to the Firm's Registration Statements other than the Firm's Registration Statement on Form S-3 (File No. 333-146731).

### Exhibit No. Description

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- |      |  |
|------|--|
| 99.1 | Consolidated Financial Statements of The Bear Stearns Companies Inc. as of November 30, 2007 and 2006, and for each of the three years in the period ended November 30, 2007, including the Report of Independent Registered Public Accounting Firm dated January 28, 2008, except for Note 23, which is as of April 11, 2008 (which report expresses an unqualified opinion and includes explanatory paragraphs referring to substantial doubt about the Company's ability to continue as a going concern, and the adoption of Statement of Financial Accounting Standards ("SFAS") No. 155, Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140 and SFAS No. 157, Fair Value Measurements).   |
| 99.2 | Historical Financial Statement Schedule of condensed financial information of The Bear Stearns Companies Inc. (Parent Company Only) as of November 30, 2007 and 2006, and for each of the three years in the period ended November 30, 2007, including the Report of Independent Registered Public Accounting Firm dated January 28, 2008, except for Note 4, which is as of April 11, 2008 (which report expresses an unqualified opinion and includes explanatory paragraphs referring to substantial doubt about the Company's ability to continue as a going concern, and the adoption of Statement of Financial Accounting Standards ("SFAS") No. 155, Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140 and SFAS No. 157, Fair Value Measurements). |

99.3 Unaudited Pro Forma Combined Financial Information of JPMorgan Chase & Co. and The Bear Stearns Companies Inc.

99.4 Unaudited Condensed Consolidated Financial Statements of The Bear Stearns Companies Inc. for the three months ended February 29, 2008 and February 28, 2007, including the Review Report of Independent Registered Public Accounting Firm dated April 14, 2008 (which report included explanatory paragraphs referring to substantial doubt about the Company's ability to continue as a going concern, and the adoption of Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109).

99.5 Consent of Deloitte & Touche LLP.

99.6 Letter Re: Unaudited Interim Financial Information.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**JPMORGAN CHASE & CO.**  
(Registrant)

*By: /s/ Anthony J. Horan*

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*Name: Anthony J. Horan*  
*Title: Corporate Secretary*

*Dated: April 16, 2008*

## Item 9.01. Financial Statements and Exhibits

### (d) Exhibits

#### Exhibit No. Description

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- 99.1 Consolidated Financial Statements of The Bear Stearns Companies Inc. as of November 30, 2007 and 2006, and for each of the three years in the period ended November 30, 2007, including the Report of Independent Registered Public Accounting Firm dated January 28, 2008, except for Note 23, which is as of April 11, 2008 (which report expresses an unqualified opinion and includes explanatory paragraphs referring to substantial doubt about the Company's ability to continue as a going concern, and the adoption of Statement of Financial Accounting Standards ("SFAS") No. 155, Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140 and SFAS No. 157, Fair Value Measurements).
- 99.2 Historical Financial Statement Schedule of condensed financial information of The Bear Stearns Companies Inc. (Parent Company Only) as of November 30, 2007 and 2006, and for each of the three years in the period ended November 30, 2007, including the Report of Independent Registered Public Accounting Firm dated January 28, 2008, except for Note 4, which is as of April 11, 2008 (which report expresses an unqualified opinion and includes explanatory paragraphs referring to substantial doubt about the Company's ability to continue as a going concern, and the adoption of Statement of Financial Accounting Standards ("SFAS") No. 155, Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140 and SFAS No. 157, Fair Value Measurements).
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- 99.6 Letter Re: Unaudited Interim Financial Information.

**THE BEAR STEARNS COMPANIES INC.**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Stockholders of The Bear Stearns Companies Inc.**

We have audited the accompanying consolidated statements of financial condition of The Bear Stearns Companies Inc. and subsidiaries (the "Company") as of November 30, 2007 and 2006, and the related consolidated statements of income, comprehensive income, cash flows, and changes in stockholders' equity for each of the three years in the period ended November 30, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of The Bear Stearns Companies Inc. and subsidiaries as of November 30, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended November 30, 2007, in conformity with accounting principles generally accepted in the United States of America.

We have not audited any financial statements of the Company for any period subsequent to November 30, 2007, nor have we performed a review of interim financial statements in conformity with the standards of the Public Company Accounting Oversight Board (United States) for any period subsequent to November 30, 2007. However, as discussed in Note 23 to the consolidated financial statements, during the end of the week of March 10, 2008, the Company experienced a significant liquidity crisis which seriously jeopardized the financial viability of the Company, and which raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regards to these matters are also discussed in Note 23. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 1 and Note 3 to the consolidated financial statements, effective December 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140" and Statement of Financial Accounting Standards No. 157, "Fair Value Measurements."

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of November 30, 2007, based on the criteria established in "Internal Control--Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 28, 2008 expressed an unqualified opinion on the Company's internal control over financial reporting.

*/s/ Deloitte & Touche LLP*  
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*New York, New York*  
*January 28, 2008*  
*(April 11, 2008 as to Note 23)*

**THE BEAR STEARNS COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF INCOME**

Fiscal Years Ended November 30,	2007	2006	2005
(in millions, except share and per share data)			
<b>REVENUES</b>			
Commissions	\$ 1,269	\$ 1,163	\$ 1,200
Principal transactions	1,323	4,995	3,836
Investment banking	1,380	1,334	1,037
Interest and dividends	11,556	8,536	5,107
Asset management and other income	623	523	372
<b>Total revenues</b>	<b>16,151</b>	<b>16,551</b>	<b>11,552</b>
Interest expense	10,206	7,324	4,141
<b>Revenues, net of interest expense</b>	<b>5,945</b>	<b>9,227</b>	<b>7,411</b>
<b>NON-INTEREST EXPENSES</b>			
Employee compensation and benefits	3,425	4,343	3,553
Floor brokerage, exchange and clearance fees	279	227	222
Communications and technology	578	479	402
Occupancy	264	198	168
Advertising and market development	179	147	127
Professional fees	362	280	229
Impairment of goodwill and specialist rights	227	--	--
Other expenses	438	406	503
<b>Total non-interest expenses</b>	<b>5,752</b>	<b>6,080</b>	<b>5,204</b>
Income before provision for income taxes	\$ 193	\$ 3,147	\$ 2,207
(Benefit from)/provision for income taxes	(40)	1,093	745
<b>Net income</b>	<b>\$ 233</b>	<b>\$ 2,054</b>	<b>\$ 1,462</b>
Preferred stock dividends	(21)	(21)	(24)
<b>Net income applicable to common shares</b>	<b>\$ 212</b>	<b>\$ 2,033</b>	<b>\$ 1,438</b>
<b>Basic earnings per share</b>	<b>\$ 1.68</b>	<b>\$ 15.79</b>	<b>\$ 11.42</b>
<b>Diluted earnings per share</b>	<b>\$ 1.52</b>	<b>\$ 14.27</b>	<b>\$ 10.31</b>
<b>Weighted average common shares outstanding:</b>			
Basic	130,208,999	131,711,382	130,326,947
Diluted	146,442,842	148,575,469	147,467,992

**See Notes to Consolidated Financial Statements.**

**THE BEAR STEARNS COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

As of November 30,	2007	2006
(in millions, except share data)		
<b>ASSETS</b>		
Cash and cash equivalents	\$ 21,406	\$ 4,595
Cash and securities deposited with clearing organizations or segregated in compliance with federal regulations	12,890	8,804
Securities received as collateral	15,599	19,648
Collateralized agreements:		
Securities purchased under agreements to resell	27,878	38,838
Securities borrowed	82,245	80,523
Receivables:		
Customers	41,115	29,482
Brokers, dealers and others	11,622	6,119
Interest and dividends	785	745
Financial instruments owned, at fair value	122,518	109,200
Financial instruments owned and pledged as collateral, at fair value	15,724	15,968
<b>Total financial instruments owned, at fair value</b>	<b>138,242</b>	<b>125,168</b>
Assets of variable interest entities and mortgage loan special purpose entities	33,553	30,245
Property, equipment and leasehold improvements, net of accumulated depreciation and amortization of \$1,149 and \$1,152 in 2007 and 2006, respectively	605	480
Other assets	9,422	5,786
<b>Total Assets</b>	<b>\$ 395,362</b>	<b>\$ 350,433</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Unsecured short-term borrowings	\$ 11,643	\$ 25,787
Obligation to return securities received as collateral	15,599	19,648
Collateralized financings:		
Securities sold under agreements to repurchase	102,373	69,750
Securities loaned	3,935	11,451
Other secured borrowings	12,361	3,275
Payables:		
Customers	83,204	72,989
Brokers, dealers and others	4,101	3,397
Interest and dividends	1,301	1,123
Financial instruments sold, but not yet purchased, at fair value	43,807	42,257
Liabilities of variable interest entities and mortgage loan special purpose entities	30,605	29,080
Accrued employee compensation and benefits	1,651	2,895
Other liabilities and accrued expenses	4,451	2,082
Long-term borrowings	68,538	54,570
<b>Total Liabilities</b>	<b>\$ 383,569</b>	<b>\$ 338,304</b>
Commitments and contingencies (Note 17)		
<b>STOCKHOLDERS' EQUITY</b>	<b>352</b>	<b>359</b>
Preferred stock		
Common stock, \$1.00 par value; 500,000,000 shares authorized as of November 30, 2007 and 2006; 184,805,847 shares issued as of November 30, 2007 and 2006	185	185
Paid-in capital	4,986	4,579
Retained earnings	9,441	9,385
Employee stock compensation plans	2,478	2,066
Accumulated other comprehensive (loss) income	(8)	--
Treasury stock, at cost:		
Common stock: 71,807,227 and 67,396,876 shares as of November 30, 2007 and 2006, respectively	(5,641)	(4,445)
<b>Total Stockholders' Equity</b>	<b>11,793</b>	<b>12,129</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 395,362</b>	<b>\$ 350,433</b>

**See Notes to Consolidated Financial Statements.**

**THE BEAR STEARNS COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Fiscal Years Ended November 30,	2007	2006	2005
(in millions)			
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 233	\$ 2,054	\$ 1,462
Adjustments to reconcile net income to cash used in operating activities:			
Non-cash items included in net income:			
Impairment of goodwill and specialist rights	227	--	--
Depreciation and amortization	186	350	277
Deferred income taxes	(33)	(85)	113
Employee stock compensation plans	31	1,010	801
Changes in operating assets and liabilities:			
Cash and securities deposited with clearing organizations or segregated in compliance with federal regulations	(4,086)	(3,534)	(847)
Securities borrowed, securities loaned, net	(9,238)	(16,261)	6,264
Receivables from customers	(11,633)	1,791	841
Receivables from brokers, dealers and others	(5,503)	(2,575)	(610)
Financial instruments owned, at fair value	(13,111)	(21,357)	(26,938)
Other assets	(4,111)	(1,597)	(831)
Securities sold under agreements to repurchase, securities purchased under agreements to resell, net	43,583	7,427	10,275
Payables to customers	10,215	3,118	(9,513)
Payables to brokers, dealers and others	704	740	57
Financial instruments sold, but not yet purchased, at fair value	1,539	8,895	3,546
Accrued employee compensation and benefits	(405)	207	171
Other liabilities and accrued expenses	2,548	596	494
<b>Cash provided by (used in) operating activities</b>	<b>11,146</b>	<b>(19,221)</b>	<b>(14,438)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of property, equipment and leasehold improvements, net	(295)	(181)	(203)
<b>Cash used in investing activities</b>	<b>(295)</b>	<b>(181)</b>	<b>(203)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Payments for/proceeds from unsecured short-term borrowings, net	(14,144)	6,026	8,030
Proceeds from/payments for other secured borrowings, net	9,086	3,021	(225)
Proceeds from issuance of long-term borrowings	24,923	19,892	15,997
Payments for retirement/repurchase of long-term borrowings	(12,495)	(10,250)	(7,273)
Proceeds from issuances of derivatives with a financing element, net	23	339	255
Issuance of common stock	162	289	202
Cash retained resulting from tax deductibility under share-based payment arrangements	254	363	426
Redemption of preferred stock	(7)	(13)	(76)
Treasury stock purchases - common stock	(1,670)	(1,374)	(870)
Cash dividends paid	(172)	(155)	(139)
<b>Cash provided by financing activities</b>	<b>5,960</b>	<b>18,138</b>	<b>16,327</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>16,811</b>	<b>(1,264)</b>	<b>1,686</b>
Cash and cash equivalents, beginning of year	4,595	5,859	4,173
<b>Cash and cash equivalents, end of period</b>	<b>\$ 21,406</b>	<b>\$ 4,595</b>	<b>\$ 5,859</b>

**Supplemental Disclosure of Cash Flow Information:**

Cash payments for interest were \$10.86 billion, \$7.93 billion and \$4.30 billion during the fiscal years ended November 30, 2007, 2006 and 2005 respectively. Cash payments for income taxes, net of refunds, were \$561 million, \$709 million and \$146 million for the fiscal years ended November 30, 2007, 2006 and 2005, respectively. Cash payments for income taxes, net of refunds, would have been \$815 million, \$1.07 billion and \$572 million for the fiscal years ended November 30, 2007, 2006 and 2005, respectively, if increases in the value of equity instruments issued under share based payment arrangements had not been deductible in determining taxable income.

**See Notes to Consolidated Financial Statements.**

**THE BEAR STEARNS COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

(in millions, except share and per share data)	Preferred Stock	Common Stock \$1 Par Value	Paid-In Capital	Retained Earnings	Employee Stock Compensation Plans	Treasury Stock-Common Stock	Total
BALANCE, NOVEMBER 30, 2004	\$ 448	\$ 185	\$ 3,548	\$ 6,177	\$ 2,509	\$ (3,876)	\$ 8,991
Net income				1,462			
Dividends declared--							
Common (\$1.00 per share)				(121)	7		
Preferred				(25)			
Treasury Stock--							
Common stock purchased (8,483,483 shares)						(870)	
Common stock issued out of treasury (18,565,624 shares)			13		(729)	921	
Redemption of preferred stock	(76)						
Income tax benefit related to distributions from employee stock compensation plans			426				
Unearned employee stock compensation, net					15		
Employee stock compensation awards, net			123		655		
Amortization of preferred stock issue costs			(1)				
BALANCE, NOVEMBER 30, 2005	\$ 372	\$ 185	\$ 4,109	\$ 7,493	\$ 2,457	\$ (3,825)	\$ 10,791
Net Income				2,054			
Dividends declared--							
Common (\$1.12 per share)				(141)	7		
Preferred				(21)			
Treasury Stock--							
Common stock purchased (10,582,214 shares)						(1,374)	
Common stock issued out of treasury (14,122,978 shares)			91		(551)	754	
Redemption of preferred stock	(13)			--			
Income tax benefit related to distributions from employee stock compensation plans			363				
Unearned employee stock compensation, net					(13)		
Employee stock compensation awards, net			17		166		
Amortization of preferred stock issue costs			(1)				
BALANCE, NOVEMBER 30, 2006	\$ 359	\$ 185	\$ 4,579	\$ 9,385	\$ 2,066	\$ (4,445)	\$ 12,129

See Notes to Consolidated Financial Statements

**THE BEAR STEARNS COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

(in millions, except share and per share data)	Preferred Stock	Common Stock \$1 Par Value	Paid-In Capital	Retained Earnings	Employee Stock Compensation Plans
BALANCE, NOVEMBER 30, 2006	\$ 359	\$ 185	\$ 4,579	\$ 9,385	\$ 2,066
Net Income				233	
Dividends declared--					
Common (\$1.28 per share)				(159)	8
Preferred				(21)	
Treasury Stock--					
Common stock purchased (12,044,779 shares)					
Common stock issued out of treasury (7,634,428 shares)			58		(370)
Redemption of preferred stock	(7)				
Income tax benefit related to distributions from employee stock compensation plans			254		

Unearned employee stock compensation, net								(31)		
Employee stock compensation awards, net			96					805		
Amortization of preferred stock issue costs			(1)							
Foreign currency translation, net of tax										
Net (losses) on cash flow hedges, net of tax										
Implementation of accounting principles							3			
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BALANCE, NOVEMBER 30, 2007	\$	352	\$	185	\$	4,986	\$	9,441	\$	2,478
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(in millions, except share and per share data)	Accumulated Other Comprehensive Income	Treasury Stock-Common Stock	Total
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BALANCE, NOVEMBER 30, 2006	\$ --	\$ (4,445)	\$ 12,129
Net Income			
Dividends declared--			
Common (\$1.28 per share)			
Preferred			
Treasury Stock--			
Common stock purchased (12,044,779 shares)		(1,670)	
Common stock issued out of treasury (7,634,428 shares)		474	
Redemption of preferred stock			
Income tax benefit related to distributions from employee stock compensation plans			
Unearned employee stock compensation, net			
Employee stock compensation awards, net			
Amortization of preferred stock issue costs			
Foreign currency translation, net of tax	2		
Net (losses) on cash flow hedges, net of tax	(10)		
Implementation of accounting principles			
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BALANCE, NOVEMBER 30, 2007	\$ (8)	\$ (5,641)	\$ 11,793
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See Notes to Consolidated Financial Statements

**THE BEAR STEARNS COMPANIES INC.**

**CONSOLIDATED STATEMENTS OF INCOME**

Fiscal Years Ended November 30,	2007	2006	2005
(in millions)			
Net Income	\$ 233	\$2,054	\$1,462
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustment	2	--	--
Net gains (losses) on cash flow hedges	(10)	--	--
Comprehensive income	\$ 225	\$2,054	\$1,462

**See Notes to Consolidated Financial Statements.**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### DESCRIPTION OF BUSINESS

The Bear Stearns Companies Inc. (the "Company") is a holding company that, through its broker-dealer and international bank subsidiaries, principally Bear, Stearns & Co. Inc. ("Bear Stearns"), Bear, Stearns Securities Corp. ("BSSC"), Bear, Stearns International Limited ("BSIL") and Bear Stearns Bank plc ("BSB"), is primarily engaged in business as a securities broker-dealer and operates in three principal segments: Capital Markets, Global Clearing Services and Wealth Management. Capital Markets is comprised of the institutional equities, fixed income and investment banking areas. Global Clearing Services provides clearance-related services for prime brokerage clients and clearance on a fully disclosed basis for introducing broker-dealers. Wealth Management is comprised of the private client services ("PCS") and asset management areas. See Note 19, "Segment and Geographic Area Data," in the Notes to Consolidated Financial Statements for a complete description of the Company's principal segments. The Company also conducts significant activities through other wholly owned subsidiaries, including: Bear Stearns Global Lending Limited; Custodial Trust Company; Bear Stearns Financial Products Inc. ("BSFP"); Bear Stearns Capital Markets Inc.; Bear Stearns Credit Products Inc.; Bear Stearns Forex Inc. ("BS Forex"); EMC Mortgage Corporation; Bear Stearns Commercial Mortgage, Inc.; Bear Stearns Investment Products Inc.; and Bear Energy L.P.

### BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest. All material intercompany transactions and balances have been eliminated in consolidation.

The Company determines whether it has a controlling financial interest in an entity by evaluating whether an entity is a voting interest entity, a variable interest entity ("VIE") or a qualifying special purpose entity ("QSPE") under generally accepted accounting principles.

Voting interest entities are consolidated in accordance with Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements," as amended. ARB No. 51 states that the usual condition for a controlling financial interest in an entity is ownership of a majority voting interest. Accordingly, the Company consolidates voting interest entities in which it has a majority voting interest. VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE occurs when an entity has a variable interest that will absorb a majority of the VIEs expected losses, receive a majority of the VIEs residual returns, or both. The entity with the controlling financial interest, known as the primary beneficiary, consolidates the VIE. In accordance with Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 46 (R), "Consolidation of Variable Interest Entities (revised December 2003)--an interpretation of Accounting Research Bulletin ("ARB") No. 51" ("FIN No. 46 (R)"), the Company consolidates any variable interest entities for which it is the primary beneficiary. The assets and related liabilities of such variable interest entities have been shown in the Consolidated Statements of Financial Condition in the captions "Assets of variable interest entities and mortgage loan special purpose entities" and "Liabilities of variable interest entities and mortgage loan special purpose entities." See Note 6, "Variable Interest Entities and Mortgage Loan Special Purpose Entities," in the Notes to Consolidated Financial Statements. QSPEs are passive entities that are commonly used in securitization transactions. Statement of Financial Accounting Standards ("SFAS") No. 140, "Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," sets forth the criteria an entity must satisfy to be a QSPE. In accordance with SFAS No. 140, the Company does not consolidate QSPEs.

When the Company does not have a controlling interest in an entity, but exerts significant influence over the entity's operating and financial decisions (generally defined as owning a voting or economic interest of 20% to 50%), the Company applies the equity method of accounting.

As of December 1, 2006, the Company has adopted Emerging Issues Task Force ("EITF") Issue No. 04-5 "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights." The EITF consensus requires a general partner in a limited partnership to consolidate the limited partnership unless the presumption of control is overcome. The general partner may overcome this presumption of control and not consolidate the entity if the limited partners have: (a) the substantive ability to dissolve or liquidate the limited partnership or otherwise remove the general partner without having to show cause; or (b) substantive participating rights in managing the partnership.

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. These principles require management to make certain estimates and assumptions, including those regarding fair value measurements, stock-based compensation, certain accrued liabilities and the potential outcome of litigation and tax matters, which may affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ materially from these estimates.

## **REVENUE RECOGNITION POLICIES**

### **Principal Transactions**

Financial instruments owned and financial instruments sold, but not yet purchased, including contractual commitments arising pursuant to futures, forward and option contracts, interest rate swaps and other derivative contracts, are recorded at fair value with the resulting net unrealized gains and losses reflected in "Principal transactions" revenues in the Consolidated Statements of Income.

### **Investment Banking and Advisory Services**

Underwriting revenues and fees for mergers and acquisitions advisory services are accrued when services for the transactions are substantially completed. Transaction expenses are deferred until the related revenue is recognized. Investment banking and advisory services revenues are presented net of transaction-related expenses.

### **Mortgage Servicing Fees and Advances**

Contractual servicing fees, late fees and other ancillary servicing fees earned for servicing mortgage loans are reflected in "Investment banking" revenues in the Consolidated Statements of Income. Contractual servicing fees are recognized when earned based on the terms of the servicing agreement. All other fees are recognized when received. In the normal course of its business, the Company makes principal, interest and other servicing advances to external investors on mortgage loans serviced for these investors. Such advances are generally recoverable from the mortgagors, related securitization trusts or from the proceeds received from the sales of the underlying properties. A charge to earnings is recognized to the extent that servicing advances are estimated to be uncollectible under the provisions of the servicing contracts.

### **Commissions**

Commission revenues primarily include fees from executing and clearing client transactions on stock, options and futures markets worldwide. These fees are recognized on a trade date basis. The Company records its share of the commission under certain clearing agreements where the Company is acting as agent for another broker, in accordance with EITF Statement No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent."

### **Asset Management and Other Income**

The Company receives advisory fees for investment management. In addition, the Company receives performance incentive fees for managing certain funds. Advisory fees are recognized over the period of advisory service. Unearned advisory fees are treated as deferred revenues and are included in "Other liabilities" in the accompanying Consolidated Statements of Financial Condition. Performance incentive fees are accrued throughout the year based on a fund's performance to date against specified performance targets.

## **Energy Trading**

Energy trading revenues are reported, net of certain direct costs, in "Principal transactions" on the Consolidated Statement of Income. Energy trading assets and liabilities that are derivatives are reported at fair value with the corresponding changes recognized in income. Non-derivative contracts are accounted for on an accrual basis and recognized in income when the energy is delivered. See Note 21, "Asset Acquisition" for a further discussion on the assets acquired from the Williams Power Company, Inc.

## **FINANCIAL INSTRUMENTS**

On December 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. Additionally, SFAS No. 157 disallows the use of block discounts on positions traded in an active market as well as nullifies certain guidance in EITF No. 02-3 regarding the recognition of inception gains on certain derivative transactions. See Note 3, "Financial Instruments" of Notes to Consolidated Financial Statements for a complete discussion of SFAS No. 157.

Financial instruments owned and financial instruments sold, but not yet purchased, including contractual commitments arising pursuant to futures, forward and option contracts, interest rate swaps and other derivative contracts, are recorded on a trade-date basis at fair value.

Fair value is generally based on quoted market prices. If quoted market prices are not available, fair value is determined based on other relevant factors, including dealer price quotations, price activity for equivalent instruments and valuation pricing models. Valuation pricing models consider time value, yield curve and volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other measurements.

Equity interests and securities acquired as a result of private equity and merchant banking activities are reflected in the consolidated financial statements at fair value, which is often represented at initial cost until significant transactions or developments indicate that a change in the carrying value of the securities is appropriate. This represents the Company's best estimate of exit price as defined by SFAS No. 157. Generally, the carrying values of these securities will be increased based on company performance and in those instances where market values are readily ascertainable by reference to substantial transactions occurring in the marketplace or quoted market prices. Reductions to the carrying value of these securities are made when the Company's estimate of fair value has declined below the carrying value.

## **DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

The Company follows SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for stand-alone derivative instruments, derivatives embedded within other contracts or securities, and hedging activities. Accordingly, all derivatives, whether stand-alone or embedded within other contracts or securities, are carried in the Company's Consolidated Statements of Financial Condition at fair value, with changes in fair value recorded in "Principal transactions" revenues. Designated hedged items in fair value hedging relationships are marked for the risk being hedged, with such changes also recorded in "Principal transactions" revenues. Derivatives designated as cash flow hedges are carried at fair value. The effective portion of the change in fair value on a derivative designated as a cash flow hedge is reported in "Accumulated other comprehensive (loss) income." The ineffective portion is reported in "Principal transactions" revenues in the Consolidated Statements of Income. Amounts that are reported in "Accumulated other comprehensive (loss) income" are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.

On December 1, 2006, the Company adopted SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140." SFAS No. 155 permits companies to elect on an instrument-by-instrument basis, to apply a fair value measurement to hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation under SFAS No. 133. As permitted, on December 1, 2006, the Company elected to apply a fair value measurement to all existing hybrid financial instruments that met the SFAS No. 155 definition. The Company has elected the fair value measurement for certain qualifying hybrid financial instruments issued on or after December 1, 2006. The Company's reason for electing to carry these instruments on a fair value basis was to enable the Company to more efficiently hedge these instruments and to simplify the accounting process. Changes in fair value are reflected in "Principal transactions" revenues in the Consolidated Statements of Income. For fiscal 2007, the increase to revenues due to changes in fair value pursuant to the election of SFAS No. 155 was \$664 million.

The Company follows FIN No. 39, "Offsetting Amounts Related to Certain Contracts," and offsets assets and liabilities in the Consolidated Statements of Financial Condition provided that the legal right of offset exists under a master netting agreement. This includes the offsetting of payables or receivables relating to the fair value of cash collateral received or paid associated with its derivative inventory, on a counterparty by counterparty basis. The amounts netted reduced Financial Instruments Owned and Payable to Customers, by \$12.5 billion as of November 30, 2007 and \$6.3 billion as of November 30, 2006, and reduced Financial Instruments Sold, But Not Yet Purchased and Receivable From Customers by \$9.6 billion as of November 30, 2007 and \$3.2 billion as of November 30, 2006.

## **CUSTOMER TRANSACTIONS**

Customer securities transactions are recorded on the Consolidated Statements of Financial Condition on a settlement date basis, which is generally three business days after trade date, while the related commission revenues and expenses are recorded on a trade-date basis. Receivables from and payables to customers include amounts related to both cash and margin transactions. Securities owned by customers, including those that collateralize margin or other similar transactions, are generally not reflected in the Consolidated Statements of Financial Condition.

## **MORTGAGE SERVICING RIGHTS**

Mortgage servicing rights ("MSRs") are included in "Other assets" on the Consolidated Statements of Financial Condition. On December 1, 2006, the Company adopted SFAS No. 156, "Accounting for Servicing of Financial Assets--an amendment of FASB Statement No. 140," and elected to measure servicing assets at fair value. The fair value of MSRs is determined by using market-based models that discount anticipated future net cash flows considering loan prepayment predictions, interest rates, default rates, servicing costs, current market data and other economic factors. Changes in the fair value of MSRs are recorded in "Principal transactions" revenues in the Consolidated Statements of Income.

## **TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES**

The Company follows SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities--a replacement of FASB Statement No. 125," to account for securitizations and other transfers of financial assets and collateral. SFAS No. 140 establishes accounting and reporting standards with a financial-components approach that focuses on control. Under this approach, financial assets or liabilities are recognized when control is established and derecognized when control has been surrendered or the liability has been extinguished. Control is deemed to be relinquished only when all of the following conditions have been met: (1) the assets have been isolated from the transferor, even in bankruptcy or other receivership; (2) the transferee is a QSPE or has the right to pledge or exchange the assets received; and (3) the transferor has not maintained effective control over the transferred assets. The Company derecognizes financial assets transferred in securitizations provided that such transfer meets all of these criteria.

Mortgage securitization transactions, net of certain direct costs, are recorded in "Principal transactions" revenues in the Consolidated Statements of Income.

## **COLLATERALIZED SECURITIES TRANSACTIONS**

Transactions involving purchases of securities under agreements to resell ("reverse repurchase agreements") or sales of securities under agreements to repurchase ("repurchase agreements") are treated as collateralized financing transactions and are recorded at their contracted resale or repurchase amounts plus accrued interest. Resulting interest income and expense is generally included in "Principal transactions" revenues in the Consolidated Statements of Income. Reverse repurchase agreements and repurchase agreements are presented in the Consolidated Statements of Financial Condition on a net-by-counterparty basis, where permitted by generally accepted accounting principles. It is the Company's general policy to take possession of securities or loans with a market value in excess of the principal amount loaned plus the accrued interest thereon, in order to collateralize reverse repurchase agreements. Similarly, the Company is generally required to provide securities or loans to counterparties to collateralize repurchase agreements. The Company's agreements with counterparties generally contain contractual provisions allowing for additional collateral to be obtained, or excess collateral returned. It is the Company's policy to value collateral and to obtain additional collateral, or to retrieve excess collateral from counterparties, when deemed appropriate.

Securities borrowed and securities loaned are recorded based upon the amount of cash collateral advanced or received. Securities borrowed transactions facilitate the settlement process and require the Company to deposit cash, letters of credit or other collateral with the lender. With respect to securities loaned, the Company receives collateral in the form of cash or other collateral. The amount of collateral required to be deposited for securities borrowed, or received for securities loaned, is an amount generally in excess of the market value of the applicable securities borrowed or loaned. The Company monitors the market value of securities borrowed and loaned, with excess collateral retrieved or additional collateral obtained, when deemed appropriate.

## **FIXED ASSETS**

Depreciation of property and equipment is calculated by the Company on a straight-line basis over the estimated useful life of the asset. Amortization of leasehold improvements is provided on a straight-line basis over the lesser of the estimated useful life of the asset or the remaining life of the lease.

## **GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS**

The Company accounts for goodwill and identifiable intangible assets under the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets." In accordance with this guidance, the Company does not amortize goodwill, but amortizes identifiable intangible assets over their useful lives. Goodwill is tested at least annually for impairment and identifiable intangible assets are tested for potential impairment whenever events or changes in circumstances suggest that the carrying value of an asset or asset group may not be fully recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." See Note 20, "Acquisition of Minority Interest and Impairment of Intangible Assets."

## **EARNINGS PER SHARE**

Earnings per share ("EPS") is computed in accordance with SFAS No. 128, "Earnings Per Share." Basic EPS is computed by dividing net income applicable to common shares, adjusted for costs related to vested shares under the Capital Accumulation Plan for Senior Managing Directors, as amended ("CAP Plan"), as well as the effect of the redemption of preferred stock, by the weighted average number of common shares outstanding. Common shares outstanding includes vested units issued under certain stock compensation plans, which will be distributed as shares of common stock. Diluted EPS includes the determinants of basic EPS and, in addition, gives effect to dilutive potential common shares related to stock compensation plans.

## STOCK-BASED COMPENSATION

The Company follows the provisions of SFAS No. 123 (R), "Share-Based Payment," to account for its stock-based compensation plans. SFAS No. 123 (R) is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." SFAS No. 123 (R) eliminated the ability to account for share-based compensation transactions using APB No. 25 and requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements using a fair value-based method. The Company adopted SFAS No. 123 (R) effective December 1, 2005, using the modified prospective method. Because the fair value recognition provisions of SFAS No. 123 and SFAS No. 123 (R) were materially consistent under the Company's equity plans, the adoption of SFAS No. 123 (R) did not have a material impact on the Company's financial position or results of operations.

Prior to the Company's adoption of SFAS No. 123 (R), tax benefits in excess of recognized compensation costs were reported as operating cash flows. SFAS No.

123 (R) requires excess tax benefits to be reported as a financing cash inflow.

The Company previously elected to adopt fair value accounting for stock-based compensation consistent with SFAS No. 123, using the prospective method with guidance provided by SFAS No. 148, "Accounting for Stock-Based Compensation--Transition and Disclosure," effective December 1, 2002. As a result, commencing with options granted after November 30, 2002, the Company expenses the fair value of stock options issued to employees over the related vesting period. Prior to December 1, 2002, the Company had elected to account for its stock-based compensation plans using the intrinsic value method prescribed by APB No. 25, as permitted by SFAS No. 123. Under the provisions of APB No. 25, compensation cost for stock options was measured as the excess, if any, of the quoted market price of the Company's common stock at the date of grant over the amount an employee must pay to acquire the stock. Accordingly, no compensation expense was recognized for stock option awards granted prior to December 1, 2002 because the exercise price was equal to the fair market value of the Company's common stock on the grant date.

The cost related to stock-based compensation included in net income for the fiscal years ended November 30, 2007 and 2006 has been fully determined under the fair value-based method, and for the fiscal year ended November 30, 2005 is less than that which would have been recognized if the fair value-based method had been applied to stock option awards since the original effective date of SFAS No. 123.

The following table illustrates the effect on net income and earnings per share if the fair value-based method had been applied to all outstanding awards in fiscal year ended November 30, 2005.

Fiscal Year Ended November 30, 2005	
(in millions, except per share amounts)	
Net income, as reported	\$ 1,462
Add: Stock-based employee compensation plan expense included in reported net income, net of related tax effect	375
Deduct: Total stock-based employee compensation plan expense determined under the fair value-based method, net of related tax effect	(387)
Pro forma net income	\$ 1,450
Earnings per share:	
Basic-as reported	\$ 11.42
Basic-pro forma	\$ 11.33
Diluted-as reported	\$ 10.31
Diluted-pro forma	\$ 10.23

## **CASH EQUIVALENTS**

The Company has defined cash equivalents as liquid investments not held for sale in the ordinary course of business with original maturities of three months or less that are not part of the Company's trading inventory.

## **INCOME TAXES**

The Company and certain of its subsidiaries file a U.S. consolidated federal income tax return. The Company accounts for income taxes under the provisions of SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred income taxes are based on the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities. In addition, deferred income taxes are determined by the enacted tax rates and laws expected to be in effect when the related temporary differences are expected to be reversed.

The Company is under continuous examination by various tax authorities in jurisdictions in which the Company has significant business operations. The Company regularly evaluates the likelihood of additional assessments in each of the tax jurisdictions resulting from these examinations. Tax reserves have been established, which the Company believes to be adequate in relation to the probability for additional assessments. Once established, reserves are adjusted as information becomes available or when an event requiring a change to the reserve occurs.

## **TRANSLATION OF FOREIGN CURRENCIES**

Assets and liabilities denominated in foreign currencies are translated at fiscal year-end rates of exchange, while income statement items are translated at daily average rates of exchange during the fiscal year. Gains or losses on translation of the financial statements of foreign subsidiaries from their respective functional currency to the U.S. dollar are included, net of tax, on the Consolidated Statements of Comprehensive Income. Gains or losses resulting from foreign currency transactions are included in current earnings.

## **ACCOUNTING AND REPORTING DEVELOPMENTS**

During fiscal 2007, the Company adopted SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments--an amendment of FASB Statements No. 133 and 140," SFAS No. 156, "Accounting for Servicing of Financial Assets--an amendment of FASB Statement No. 140," and SFAS No. 157, "Fair Value Measurements." As a result of the adoption of these standards, the Company recorded a cumulative effect adjustment to increase the opening retained earnings balance by approximately \$3.5 million (after tax).

In December 2007, the FASB issued Statement No. 141 R, "Business Combinations (a revision of Statement No. 141)." This Statement applies to all transactions or other events in which an entity obtains control of one or more businesses, including those combinations achieved without the transfer of consideration. This Statement retains the fundamental requirements in Statement No. 141 that the acquisition method of accounting be used for all business combinations. This Statement expands the scope to include all business combinations and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their fair values as of the acquisition date. Additionally, FASB No. 141R changes the way entities account for business combinations achieved in stages by requiring the identifiable assets and liabilities to be measured at their full fair values. Additionally, contractual contingencies and contingent consideration shall be measured at fair value at the acquisition date. This Statement is effective on a prospective basis to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of this Statement will have on the consolidated financial statements of the Company.

In December 2007, the FASB issued Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No.51". This Statement amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Additionally, this Statement requires that consolidated net income include the amounts attributable to both the parent and the noncontrolling interest. This Statement is effective for interim periods beginning on or after December 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of this Statement will have on the consolidated financial statements of the Company.

In June 2007, the FASB's Emerging Issues Task Force (EITF) issued EITF Issue No. 06-11 "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." This issue requires that the tax benefits related to dividend equivalents paid on restricted stock units, which are expected to vest, be recorded as an increase to additional paid-in capital. EITF 06-11 is effective prospectively to the income tax benefits on dividends declared in fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact, if any, the adoption of this issue may have on the Company's consolidated financial statements and does not expect a material impact on the consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 permits entities to elect to measure financial assets and liabilities (except for those that are specifically scoped out of the Statement) at fair value. The election to measure a financial asset or liability at fair value can be made on an instrument-by-instrument basis and is irrevocable. The difference between the carrying value and the fair value at the election date is recorded as a transition adjustment to opening retained earnings. Subsequent changes in fair value are recognized in earnings. The Company adopted SFAS No. 159 effective December 1, 2007. The adoption of SFAS No. 159 did not have a material impact on the consolidated financial statements of the Company.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109" ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company will adopt the provisions of FIN No. 48 beginning in the first quarter of 2008. The adoption of FIN No. 48 will not have a material impact on the consolidated financial statements of the Company.

In April 2007, the FASB issued a Staff Position ("FSP") FIN No. 39-1, "Amendment of FASB Interpretation No. 39." FSP FIN No. 39-1 defines "right of setoff" and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. It also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts recognized for those instruments in the Consolidated Statement of Financial Condition. In addition, this FSP permits offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. The provisions of this FSP are consistent with the Company's current accounting practice. The Company adopted the provisions of FSP FIN No. 39-1 on December 1, 2007. The adoption of FSP FIN No. 39-1 did not impact the consolidated financial statements of the Company.

## 2. FAIR VALUE OF FINANCIAL INSTRUMENTS

Substantially all of the Company's assets and liabilities are carried at fair value or contracted amounts that approximate fair value. Assets that are recorded at contracted amounts approximating fair value consist largely of short-term secured receivables, including reverse repurchase agreements, securities borrowed, customer receivables and certain other receivables. Similarly, the Company's short-term liabilities, such as bank loans, commercial paper, medium-term notes, structured notes, repurchase agreements, securities loaned, customer payables and certain other payables, are recorded at contracted amounts approximating fair value. These instruments generally have variable interest rates and/or short-term maturities, in many cases overnight, and accordingly, their fair values are not materially affected by changes in interest rates.

The Company uses derivatives to modify the interest rate characteristics of its long- and short-term debt. The Company generally enters into interest rate swaps and other transactions designed to either convert its fixed-rate debt into floating-rate debt or otherwise hedge its exposure to changes in interest rates.

## 3. FINANCIAL INSTRUMENTS

Financial instruments owned and financial instruments sold, but not yet purchased, consisting of the Company's proprietary trading inventories, at fair value, as of November 30, 2007 and 2006, were as follows:

(in millions)	2007		2006	
-----				
FINANCIAL INSTRUMENTS OWNED, AT FAIR VALUE:				
U.S. government and agency	\$	12,920	\$	10,842
Other sovereign governments		672		1,372
Corporate equity and convertible debt		32,454		28,893
Corporate debt and other		26,330		32,551
Mortgages, mortgage- and asset-backed		46,141		39,893
Derivative financial instruments		19,725		11,617
		-----		-----
	\$	138,242	\$	125,168
=====				
FINANCIAL INSTRUMENTS SOLD, BUT NOT YET PURCHASED, AT FAIR VALUE:				
U.S. government and agency	\$	4,563	\$	11,724
Other sovereign governments		2,473		1,275
Corporate equity and convertible debt		18,843		12,623
Corporate debt and other		4,373		4,451
Mortgages, mortgage- and asset-backed		63		319
Derivative financial instruments		13,492		11,865
		-----		-----
	\$	43,807	\$	42,257
=====				

As of November 30, 2007 and 2006, all financial instruments owned that were pledged to counterparties where the counterparty has the right, by contract or custom, to rehypothecate those securities are classified as "Financial Instruments Owned and Pledged as Collateral, at Fair Value" in the Consolidated Statements of Financial Condition.

Financial instruments sold, but not yet purchased, represent obligations of the Company to purchase the specified financial instrument at the then-current market price. Accordingly, these transactions result in off-balance-sheet risk as the Company's ultimate obligation to repurchase such securities may exceed the amount recognized in the Consolidated Statements of Financial Condition.

## **CONCENTRATION RISK**

The Company is subject to concentration risk by holding large positions or committing to hold large positions in certain types of securities, securities of a single issuer (including governments), issuers located in a particular country or geographic area, or issuers engaged in a particular industry. Positions taken and commitments made by the Company, including underwritings, often involve substantial amounts and significant exposure to individual issuers and businesses, including non-investment-grade issuers. At November 30, 2007, the Company's most significant concentrations are related to United States government securities, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation agency mortgage-backed securities, which are included in the U.S. government and agency and mortgages, mortgage- and asset-backed inventory captions above. In addition, a substantial portion of the collateral held by the Company for reverse repurchase agreements consists of securities issued by the U.S. government and agencies.

## **FAIR VALUE MEASUREMENTS**

On December 1, 2006, the Company adopted SFAS No. 157, "Fair Value Measurements." SFAS No. 157 applies to all financial instruments that are measured and reported on a fair value basis. This includes items currently reported in "Financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value" on the Consolidated Statements of Financial Condition as well as financial instruments reported in "Other assets" and "Other liabilities" that are reported at fair value.

As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as exchange-traded derivatives and listed equities. This category also includes financial instruments that are valued using alternative approaches but for which the Company typically receives independent external valuation information including U.S. Treasuries, other U.S. Government and agency securities and certain cash instruments such as money market funds and certificates of deposit.

Level 2 includes financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category include sovereign debt, certain corporate equities, corporate debt, certain U.S. agency and non-agency mortgage-backed securities and non-exchange-traded derivatives such as interest rate swaps.

Level 3 is comprised of financial instruments whose fair value is estimated based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable. Included in this category are distressed debt, non-performing mortgage-related assets, certain performing residential and commercial mortgage loans, certain mortgage- and asset-backed securities and residual interests, Chapter 13 and other credit card receivables from individuals, and complex derivative structures including long-dated equity derivatives.

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to SFAS No. 157. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

#### Fair Value Measurements on a Recurring Basis as of November 30, 2007:

Balance as of (in millions)	Level 1	Level 2	Level 3	Impact of Netting	November 30, 2007
Financial Instruments Owned, at fair value					
U.S. government and agency	\$ 3,680	\$ 9,240	\$ -	\$ -	\$ 12,920
Other sovereign governments	-	672	-	-	672
Corporate equity and convertible debt	23,984	8,208	262	-	32,454
Corporate debt and other	447	21,315	4,568	-	26,330
Mortgages, mortgage- and asset-backed	-	28,891	17,250	-	46,141
Total Non Derivative Trading Assets	28,111	68,326	22,080	-	118,517
Derivative financial instruments (1)	928	157,370	2,331	(140,904)	19,725
Total Financial Instruments Owned, at fair value	29,039	225,696	24,411	(140,904)	138,242
Other Assets (2)	428	1,450	3,758	-	5,636
Total Assets at fair value	\$ 29,467	\$ 227,146	\$ 28,169	\$ (140,904)	\$ 143,878

(in millions)	Level 1	Level 2	Level 3	Impact of Netting	Balance as of November 30, 2007
Financial Instruments Sold But Not Yet Purchased, at fair value					
U.S. government and agency	\$ (4,563)	\$ -	\$ -	\$ -	\$ (4,563)
Other sovereign governments	-	(2,473)	-	-	(2,473)
Corporate equity and convertible debt	(18,327)	(516)	-	-	(18,843)
Corporate debt and other	-	(4,367)	(6)	-	(4,373)
Mortgages, mortgage- and asset-backed	-	(11)	(52)	-	(63)
Total Non Derivative Trading Liabilities	(22,890)	(7,367)	(58)	-	(30,315)
Derivative financial instruments (1)	(110)	(148,481)	(2,920)	138,019	(13,492)
Total Financial Instruments Sold But Not Yet Purchased, at fair value	(23,000)	(155,848)	(2,978)	138,019	(43,807)
Other Liabilities (3)	(96)	(7,588)	(1,254)	-	(8,938)
Total Liabilities at fair value	\$ (23,096)	\$ (163,436)	\$ (4,232)	\$ 138,019	\$ (52,745)

(1) The derivatives trading inventory balances are reported on a gross basis by level with a corresponding adjustment for netting.

(2) Other assets includes certain items such as alternative investments, mortgage servicing rights, net assets of variable interest entities and mortgage securitizations that did not meet the criteria for sale treatment under SFAS No. 140.

(3) Other liabilities are primarily comprised of certain hybrid debt issuances accounted for at fair value as elected in accordance with SFAS No. 155.

As stated above SFAS No. 157 applies to all financial assets and liabilities that are reported on a fair value basis. These valuations are adjusted for various factors including credit risk. For applicable financial assets carried at fair value, the credit standing of the counterparties is analyzed and factored into the fair value measurement of those assets. SFAS No. 157 states that the fair value measurement of a liability must reflect the nonperformance risk of the entity. Therefore, the impact of credit standing as well as any potential credit enhancements (e.g. collateral) has been factored into the fair value measurement of both financial assets and liabilities.

The derivative financial instruments balances in the table above are reported on a gross basis by level with a netting adjustment presented separately in the "Impact of Netting" column. The Company often enters into different types of derivative contracts with a single counterparty and these contracts are covered under one ISDA master netting agreement. The fair value of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy.

The following table provides a reconciliation of the beginning and ending balances for the major classes of assets and liabilities measured at fair value using significant unobservable inputs (Level 3):

#### Level 3 Financial Assets and Liabilities Year Ended November 30, 2007

#### Changes in

(in millions)	Beginning Balance as of December 1, 2006	Total Gains/ (Losses) (Realized and Unrealized)	Purchases, Issuances, Sales and Settlements	Transfers In/Out of Level 3	Ending Balance as of November 30, 2007	Unrealized Gains/(Losses) relating to Assets and Liabilities held at the reporting date
Non-Derivative Trading Assets	\$ 9,000	\$ (1,891)	\$ 10,606	\$ 4,365	\$ 22,080	\$ (1,016)
Non Derivative Trading Liabilities	\$ (190)	\$ (19)	\$ 451	\$ (300)	\$ (58)	\$ 2
Derivative Trading Inventory (Net)	\$ (2,223)	\$ 375	\$ 1,435	\$ (176)	\$ (589)	\$ 584
Other Assets	\$ 2,836	\$ (391)	\$ 783	\$ 530	\$ 3,758	\$ (934)
Other Liabilities	\$ (3,515)	\$ 201	\$ 1,603	\$ 457	\$ (1,254)	\$ 43

#### Non-Derivative Trading Assets and Liabilities

Realized and unrealized gains and losses on Level 3 assets and liabilities are primarily reported in "Principal transactions" revenues in the Consolidated Statements of Income. The Level 3 non-derivative trading assets reflect an unrealized loss related to the mortgage related inventory write-downs incurred during the fourth quarter of 2007. The Company manages its exposure on a portfolio basis and regularly engages in offsetting strategies in which financial instruments from one fair value hierarchy level are used to economically offset the risk of financial instruments in the same or different levels. Therefore, realized and unrealized gains and losses reported as Level 3 may be offset by gains or losses attributable to assets or liabilities classified in Level 1 or Level 2.

#### Derivative Trading Inventory (Net)

The net derivative trading inventory resulted in a gain for fiscal 2007. This gain was primarily driven by changes in interest rates and credit spreads related to the Company's interest rate and credit derivative products.

#### Transfers

The Company reviews the fair value hierarchy classifications on a monthly basis. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in/out of Level 3 at fair value in the month in which the changes occur.

During fiscal 2007, there were significant transfers into Level 3. The majority of these transfers related to mortgage and mortgage-related securities. The largest contributors to the transfers were to commercial loans, performing residential loans and investment grade CDOs. These transfers were primarily driven by the fact that there a significant reduction in observable trading activity for these instruments during the latter part of fiscal 2007.

#### 4. DERIVATIVES AND HEDGING ACTIVITIES

The Company, in its capacity as a dealer in over-the-counter derivative financial instruments and its proprietary market-making and trading activities, enters into transactions in a variety of cash and derivative financial instruments for proprietary trading and to manage its exposure to market and credit risk. These risks include interest rate, exchange rate, equity price and commodity price risk. Derivative financial instruments represent contractual commitments between counterparties that derive their value from changes in an underlying interest rate, currency exchange rate, index (e.g., Standard & Poor's 500 Index), reference rate (e.g., London Interbank Offered Rate, or LIBOR), or asset value referenced in the related contract. Some derivatives, such as futures contracts, certain options and index-referenced warrants, can be traded on an exchange. Other derivatives, such as interest rate and currency swaps, caps, floors, collars, swaptions, equity swaps and options, credit derivatives, structured notes and forward contracts, are negotiated in the over-the-counter markets. Derivatives generate both on- and off-balance-sheet risks depending on the nature of the contract. Generally, these financial instruments represent commitments or rights to exchange interest payment streams or currencies or to purchase or sell other securities at specific terms at specified future dates. Option contracts generally provide the holder with the right, but not the obligation, to purchase or sell a financial instrument at a specific price on or before an established date or dates. Financial instruments sold, but not yet purchased may result in market and/or credit risk in excess of amounts recorded in the Consolidated Statements of Financial Condition.

##### **MARKET RISK**

Derivative financial instruments involve varying degrees of off-balance-sheet market risk, whereby changes in the level or volatility of interest rates, foreign currency exchange rates or market values of the underlying financial instruments may result in changes in the value of a particular financial instrument in excess of the amounts currently reflected in the Consolidated Statements of Financial Condition. The Company's exposure to market risk is influenced by a number of factors, including the relationships among and between financial instruments with off-balance-sheet risk, the Company's proprietary securities, futures and derivatives inventories as well as the volatility and liquidity in the markets in which the financial instruments are traded. The Company mitigates its exposure to market risk by entering into offsetting transactions, which may include over-the-counter derivative contracts or the purchase or sale of interest-bearing securities, equity securities, financial futures and forward contracts. In this regard, the utilization of derivative instruments is designed to reduce or mitigate market risks associated with holding dealer inventories or in connection with arbitrage-related trading activities.

##### **DERIVATIVES CREDIT RISK**

Credit risk arises from the potential inability of counterparties to perform in accordance with the terms of the contract. At any point in time, the Company's exposure to credit risk associated with counterparty non-performance is generally limited to the net replacement cost of over-the-counter contracts, net of the value of collateral held. Such financial instruments are reported at fair value on a net-by-counterparty basis pursuant to enforceable netting agreements. Exchange-traded financial instruments, such as futures and options, generally do not give rise to significant unsecured counterparty exposure due to margin requirements of the exchanges, as well as the Company's internal margin requirements, which may be greater than those prescribed by the individual exchanges. Options written by the Company generally do not give rise to counterparty credit risk since they obligate the Company (not its counterparty) to perform.

The Company has controls in place to monitor credit exposures by assessing the future creditworthiness of counterparties and limiting transactions with specific counterparties. The Company also seeks to control credit risk by following an established credit approval process, monitoring credit limits and requiring collateral where appropriate.

## **HEDGING ACTIVITY**

To modify the interest rate characteristics of its long- and short-term debt, the Company also engages in non-trading derivatives activities. The Company has issued U.S. dollar-and foreign currency-denominated debt with both variable- and fixed-rate interest payment obligations. The Company has entered into interest rate swaps, primarily based on LIBOR, to convert fixed-rate interest payments on its debt obligations into variable-rate payments. In addition, for foreign currency debt obligations that are not used to fund assets in the same currency, the Company has entered into currency swap agreements that effectively convert the debt into U.S. dollar obligations. Such transactions are accounted for as fair value hedges.

These financial instruments are subject to the same market and credit risks as those that are traded in connection with the Company's market-making and trading activities. The Company has similar controls in place to monitor these risks. Interest rate swap agreements increased interest expense on the Company's long- and short-term debt obligations by \$506 million and \$376 million during the fiscal years ended November 30, 2007 and 2006, respectively and reduced interest expense on the Company's long- and short-term debt obligations by \$115 million during the fiscal year ended November 30, 2005.

SFAS No. 133, as amended by SFAS No. 138 and SFAS No. 149, establishes accounting and reporting standards for stand-alone derivative instruments, derivatives embedded within other contracts or securities and for hedging activities. It requires that all derivatives, whether stand-alone or embedded within other contracts or securities be carried on the Company's Consolidated Statements of Financial Condition at fair value. SFAS No. 133 also requires the value of items designated as being fair value hedged to be adjusted for the risk being hedged, as defined in SFAS No. 133, provided that the intent to hedge is fully documented. Any resultant net change in value for both the hedging derivative and the hedged item for the risk being hedged is recognized in earnings immediately, such net effect being deemed the "ineffective" portion of the hedge. The gains and losses associated with the ineffective portion of the fair value hedges are included in "Principal transactions" revenues in the Consolidated Statements of Income. These amounts were immaterial for fiscal 2007, 2006 and 2005.

The Company also engages in non-trading derivative activities to manage commodity price risks resulting from exposures to changes in spot and forward prices in electricity and natural gas. The company actively manages these risks with exchange traded futures, swaps, OTC swaps and options. Certain of these transactions are accounted for as cash flow hedges as defined in SFAS No. 133 which requires the effective portion of the unrealized gain or loss on a derivative designated as a cash flow hedge, as defined in SFAS No. 133, to be reported in "Accumulated other comprehensive income" ("OCI") with the ineffective portion reported in "Principal transactions" revenues in the Consolidated Statements of Income. Amounts that are reported in OCI are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of cash flow hedges was deemed immaterial for fiscal 2007.

The net loss on derivative instruments designated in cash flow hedging relationships recorded in OCI, net of tax, was \$10 million at November 30, 2007, which represents the net change in fair value recorded in OCI in fiscal 2007. The net loss in OCI is expected to be reclassified into earnings as follows: \$4 million in fiscal 2008 and the remaining \$6 million of losses within five years.

## 5. TRANSFERS OF FINANCIAL ASSETS AND LIABILITIES

### SECURITIZATIONS

The Company is a market leader in mortgage-backed securitizations and other structured financing arrangements. In the normal course of business, the Company regularly securitizes commercial and residential mortgages, consumer receivables and other financial assets. Securitization transactions are generally treated as sales, provided that control has been relinquished. In connection with securitization transactions, the Company establishes special-purpose entities ("SPEs"), in which transferred assets, including commercial and residential mortgages, consumer receivables and other financial assets are sold to an SPE and repackaged into securities or similar beneficial interests. Transferred assets are recorded at fair value prior to securitization. The majority of the Company's involvement with SPEs relates to securitization transactions meeting the definition of a QSPE under the provisions of SFAS No. 140. Provided it has relinquished control over such assets, the Company derecognizes financial assets transferred in securitizations and does not consolidate the financial statements of QSPEs. For SPEs that do not meet the QSPE criteria, the Company uses the guidance in FIN No. 46 (R) to determine whether the SPE should be consolidated.

In connection with these securitization activities, the Company may retain interests in securitized assets in the form of senior or subordinated securities or as residual interests. Retained interests in securitizations are generally not held to maturity and typically are sold shortly after the settlement of a securitization. The weighted average holding period for retained interest positions in inventory at November 30, 2007 and 2006 was approximately 180 days and 150 days, respectively. These retained interests are included in "Financial instruments owned, at fair value" in the Consolidated Statements of Financial Condition and are carried at fair value. Consistent with the valuation of similar inventory, fair value is determined by broker-dealer price quotations and internal valuation pricing models that utilize variables such as yield curves, prepayment speeds, default rates, loss severity, interest rate volatilities and spreads. The assumptions used for pricing variables are based on observable transactions in similar securities and are further verified by external pricing sources, when available.

The Company's securitization activities are detailed below:

(in billions)	Agency Mortgage-Backed	Other Mortgage- and Asset-Backed	Total
-----			
Total securitizations			
Fiscal 2007	\$ 23.0	\$ 73.8	\$ 96.8
Fiscal 2006	\$ 21.8	\$ 99.3	\$ 121.1
-----			

The following table summarizes the Company's retained interests by rating as of November 30, 2007 and 2006:

(in billions)	November 30, 2007	November 30, 2006
-----		
Retained Interests:		
AAA rated Agency Mortgage-Backed	\$2.4	\$1.5
AAA rated Other Mortgage-and Asset-Backed	2.7	1.5
-----		
Total AAA rated	\$5.1	\$3.0
Other investment grade	1.6	1.3
Non-investment grade	1.3	1.3
-----		
Total retained interests	\$8.0	\$5.6
=====		

The following table summarizes cash flows from securitization trusts related to securitization transactions during the fiscal years ended November 30, 2007 and 2006:

(in millions)	Agency Mortgage-Backed	Other Mortgage- and Asset-Backed	Total
Cash flows received from retained interests			
Fiscal 2007	\$ 254	\$ 748	\$ 1,002
Fiscal 2006	\$ 296	\$ 760	\$ 1,056
Cash flows from servicing			
Fiscal 2007	\$ 1	\$ 68	\$ 69
Fiscal 2006	\$ -	\$ 90	\$ 90

The Company is an active market maker in mortgage-backed securities and therefore may retain interests in assets it securitizes, predominantly highly rated or government agency-backed securities. The models employed in the valuation of retained interests consider possible changes in prepayment speeds in response to changes in future interest rates, as well as potential credit losses. Prepayment speed changes are incorporated by calibrating the distribution of possible future interest rates to the observed levels of implied volatility in the market for interest rate options and generating the corresponding cash flows for the securities using prepayment models. Credit losses are considered through explicit loss models for positions exposed to significant default risk in the underlying collateral, and through option-adjusted spreads that also incorporate additional factors such as liquidity and model uncertainty for all positions. The models use discount rates that are based on the Treasury curve, plus the option-adjusted spread. Key points on the constant maturity Treasury curve at November 30, 2007 were 3.03% for 2-year Treasuries and 4.14% for 10-year Treasuries, and ranged from 3.03% to 4.47%. The weighted average spread was 116 basis points and 411 basis points for agency mortgage-backed securities and other mortgage- and asset-backed securities, respectively, at November 30, 2007.

Weighted average key economic assumptions used in measuring the fair value of retained interests in assets the Company securitized at November 30, 2007 were as follows:

	Agency Mortgage-Backed	Other Mortgage- and Asset-Backed
Weighted average life (years)	5.7	2.8
Average prepayment speeds (annual rate)	7% - 39%	6% - 39%
Credit losses	-	0.5% - 49%

The following hypothetical sensitivity analysis as of November 30, 2007 illustrates the potential adverse change in fair value of these retained interests due to a specified change in the key valuation assumptions. The interest rate changes represent a parallel shift in the Treasury curve. This shift considers the corresponding effect of other variables, including prepayments. The remaining valuation assumptions are changed independently. Retained interests in securitizations are generally not held to maturity and are typically sold shortly after the settlement of a securitization. The Company considers the current and expected credit profile of the underlying collateral in determining the fair value and periodically updates the fair value for changes in credit, interest rate, prepayment speeds and other pertinent market factors. Changes in portfolio composition, updates to loss and prepayment models, and changes in the level of interest rates and market prices for retained interests, can combine to produce significant changes in the sensitivities reported even if aggregate market values do not change significantly. Actual credit losses on retained interests have not been significant.

(in millions)	Agency Mortgage-Backed	Other Mortgage- and Asset-Backed
Interest rates		
Impact of 50 basis point adverse change	\$ (66)	\$ (144)
Impact of 100 basis point adverse change	(143)	(284)
Prepayment speeds		
Impact of 10% adverse change	(5)	(31)
Impact of 20% adverse change	(8)	(54)
Credit losses		
Impact of 10% adverse change	(10)	(222)
Impact of 20% adverse change	(19)	(408)

The above table should be viewed with caution since the changes in a single variable generally cannot occur without changes in other variables or conditions that may counteract or amplify the effect of the changes outlined in the table. Changes in fair value based on adverse variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value is not usually linear. In addition, the table does not consider the change in fair value of offsetting positions, which would generally offset the changes detailed in the table, nor does it consider any corrective action that the Company may take in response to changes in these conditions. The impact of offsetting positions is not presented because these positions are established on a portfolio level and allocating the impact would not be practicable.

## MORTGAGE SERVICING RIGHTS

In the normal course of business, the Company originates and purchases conforming and non-conforming, conventional fixed-rate and adjustable-rate residential mortgage loans and sells such loans to investors. In connection with these activities, the Company may retain MSRMs that entitle the Company to a future stream of cash flows based on the contractual servicing fee. In addition, the Company may purchase and sell MSRMs.

As of December 1, 2006, the Company adopted SFAS No. 156 and elected to carry its MSRMs at fair value, with changes in fair value reported in earnings. Prior to December 1, 2006, the Company reported the MSRMs on a lower of cost or market basis.

The determination of fair value of the Company's MSRMs requires management judgment because they are not actively traded. The determination of fair value for MSRMs requires valuation processes which combine the use of discounted cash flow models and extensive analysis of current market data to arrive at an estimate of fair value. The cash flow and prepayment assumptions used in the Company's discounted cash flow model are based on empirical data drawn from the historical performance of the Company's MSRMs adjusted to reflect current market conditions, which the Company believes are consistent with assumptions used by market participants valuing similar MSRMs. The key risks and therefore the key assumptions used in the valuation of MSRMs include mortgage prepayment speeds, discount rates and constant default rates. These variables can, and generally will, change from quarter to quarter as market conditions and projected interest rates change. The Company mitigates the income statement effect of changes in fair value of MSRMs by entering into offsetting economic transactions.

At November 30, 2007, the key economic assumptions and the sensitivity of the current fair value of MSRMs to immediate changes in those assumptions were as follows:

(in millions)	
Fair value of MSRMs	\$ 833
Weighted average constant prepayment rate (CPR)	14%
Impact on fair value of:	
10% adverse change	\$ (33)
20% adverse change	(70)
Weighted average discount rate	13%
Impact on fair value of:	
10% adverse change	\$ (26)
20% adverse change	(51)
Weighted average constant default rate (CDR)	5%
Impact on fair value of:	
10% adverse change	\$ (29)
20% adverse change	(58)

The above table should be viewed with caution since the changes in a single variable generally cannot occur without changes in other variables or conditions that may counteract or amplify the effect of the changes outlined in the table. Changes in fair value based on adverse variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value is not usually linear. In addition, the table does not consider the change in fair value of offsetting positions, which would generally offset the changes detailed in the table, nor does it consider any corrective action that the Company may take in response to changes in these conditions. The impact of offsetting positions is not presented because these positions are established on a portfolio level and allocating the impact would not be practicable.

MSRs are included in "Other assets" on the Consolidated Statements of Financial Condition and are carried at fair value as of December 1, 2006, in accordance with SFAS No. 156. The Company's MSR activities for the fiscal year ended November 30, 2007 were as follows:

(in millions)	2007
Balance, beginning of year	\$ 502
Additions	351
Paydowns	(153)
Changes in fair value resulting from changes in valuation inputs/assumptions	133
Balance, end of year	\$ 833

The Company's MSR activities for the fiscal year ended November 30, 2006, carried at the lower of amortized cost or market, were as follows:

(in millions)	2006
Balance, beginning of year	\$ 431
Additions	366
Sales, net	(109)
Amortization	(188)
Recovery	2
Balance, end of year	\$ 502

Changes in the MSR valuation allowance for the fiscal year ended November 30, 2006 were as follows:

(in millions)	2006
Balance, beginning of year	\$ (11)
Recovery	2
Balance, end of year	\$ (9)

## 6. VARIABLE INTEREST ENTITIES AND MORTGAGE LOAN SPECIAL PURPOSE ENTITIES

The Company regularly creates or transacts with entities that may be VIEs. These entities are an essential part of the Company's securitization, asset management and structured finance businesses. In addition, the Company purchases and sells financial instruments that may be variable interests. The Company follows the guidance in FIN No. 46 (R) and consolidates VIEs in which the Company is the primary beneficiary.

The Company may perform various functions, including acting as the seller, servicer, investor, structurer or underwriter in securitization transactions. These transactions typically involve entities that are considered to be QSPEs as defined in SFAS No. 140. QSPEs are exempt from the requirements of FIN No. 46 (R). For securitization vehicles that do not qualify as QSPEs, the holders of the beneficial interests have no recourse to the Company, only to the assets held by the related VIE. In certain of these VIEs, the Company could be determined to be the primary beneficiary through its ownership of certain beneficial interests, and would, therefore, be required to consolidate the assets and liabilities of the VIE.

The Company has mortgage securitizations that did not meet the criteria for sale treatment under SFAS No. 140, including transactions where the retained call option did not meet the definition of a clean up call under SFAS No. 140. As such, the Company continues to carry the assets and liabilities from these transactions on its Consolidated Statements of Financial Condition.

The Company acts as portfolio manager and/or underwriter in several collateralized debt obligation and collateralized loan obligation transactions. In these transactions, the Company establishes a trust that purchases a portfolio of assets and issues trust certificates that represent interests in the portfolio of assets. The holders of the trust certificates have recourse only to the underlying assets of the trusts and not to the Company's other assets. In addition, the Company may receive variable compensation for managing the portfolio and may also retain certain trust certificates. In certain of these transactions, these interests result in the Company becoming the primary beneficiary of these entities.

The Company establishes and operates funds for the benefit of its employees. These funds are considered to be VIEs of which the Company is the primary beneficiary.

The Company has made investments in entities that own power plants. Certain entities are VIEs of which the Company is the primary beneficiary.

The following table sets forth the Company's total assets and maximum exposure to loss associated with its significant variable interests in consolidated VIEs and securitizations that did not qualify for sale treatment. This information is presented based on principal business activity.

(in millions)	As of November 30, 2007		As of November 30, 2006	
	VIE Assets	Maximum Exposure to Loss (1)	VIE Assets	Maximum Exposure to Loss (1)
Mortgage Securitizations	\$ 30,313	\$ 2,075	\$ 28,985	\$ 762
Collateralized Debt and Loan Obligations	2,150	297	685	48
Employee Funds(2)	650	445	575	355
Energy Investments	440	131	-	-
<b>Total</b>	<b>\$ 33,553</b>	<b>\$ 2,948</b>	<b>\$ 30,245</b>	<b>\$ 1,165</b>

(1) Represents the fair value of the Company's interest in these entities.

(2) Maximum exposure to loss includes loans the Company has made to employees who participate in the funds, for which the Company is in a second loss position.

The Company also owns significant variable interests in several VIEs related to collateralized debt obligations and collateralized loan obligations for which the Company is not the primary beneficiary and therefore does not consolidate these entities. In aggregate, these VIEs had assets of approximately \$11.5 billion and \$14.8 billion at November 30, 2007 and 2006, respectively. At November 30, 2007 and 2006, the Company's maximum exposure to loss from these entities was approximately \$112 million and \$163 million, respectively, which represents the fair value of its interests and are included in "Financial instruments owned, at fair value" in the Consolidated Statements of Financial Condition.

The Company purchases and sells interests in entities that may be deemed to be VIEs in its market-making capacity in the ordinary course of business. As a result of these activities, it is reasonably possible that such entities may be consolidated or deconsolidated at various points in time. Therefore, the Company's variable interests included above may not be held by the Company in future periods.

## 7. COLLATERALIZED FINANCING ARRANGEMENTS

The Company enters into secured borrowing and lending agreements to obtain collateral necessary to effect settlements, finance inventory positions, meet customer needs or re-lend as part of its dealer operations.

The Company receives collateral under reverse repurchase agreements, securities borrowing transactions, derivative transactions, customer margin loans and other secured lending activities. In many instances, the Company is also permitted by contract or custom to rehypothecate securities received as collateral. These securities may be used to secure repurchase agreements, enter into securities lending or derivative transactions or cover short positions.

At November 30, 2007 and 2006, the fair value of securities received as collateral by the Company that can be repledged, delivered or otherwise used was \$280 billion and \$286 billion, respectively. Of these securities received as collateral, those with a fair value of approximately \$189 billion and \$190 billion were delivered, repledged or otherwise used at November 30, 2007 and 2006, respectively.

The Company also pledges financial instruments owned to collateralize certain financing arrangements and permits the counterparty to pledge or rehypothecate the securities. These securities are recorded as "Financial instruments owned and pledged as collateral, at fair value" in the Consolidated Statements of Financial Condition. The carrying value of securities and other inventory positions owned that have been pledged or otherwise encumbered to counterparties where those counterparties do not have the right to sell or repledge was \$65 billion and \$42 billion at November 30, 2007 and 2006, respectively.

## 8. SHORT-TERM BORROWINGS

The Company obtains unsecured short-term borrowings through the issuance of commercial paper, bank loans, medium term notes and other borrowings. In addition, the Company obtains secured short-term borrowings primarily through master notes and secured bank loans. A master note is an agreement under which a lender may make one or more loans to a borrower, the repayment obligation of which is reflected in a promissory note to the lender. In the case of secured master notes, these agreements are secured by collateral. The interest rates on such short-term borrowings reflect market rates of interest at the time of the transactions.

The Company's short-term borrowings at November 30, 2007 and 2006 consisted of the following:

(in billions)	2007		2006	
-----				
Unsecured borrowings:				
Commercial paper	\$	3.9	\$	20.7
Bank loans		3.1		1.7
Medium term notes		1.9		0.3
Other unsecured borrowings		2.7		3.1
-----				
Total unsecured borrowings		11.6		25.8
Secured borrowings		12.4		3.3
-----				
Total short-term borrowings	\$	24.0	\$	29.1
=====				

The effective weighted average interest rates for short-term borrowings were as follows:

Fiscal Years Ended	As of November 30,		November 30,		
	2007	2006	2007	2006	2005
-----					
Commercial paper	4.67%	5.25%	5.34%	4.92%	3.28%
Bank loans and other borrowings	4.90%	5.23%	5.19%	4.74%	3.33%
-----					

### **Committed Credit Facilities**

The Company has a committed revolving credit facility ("Facility") totaling \$4.0 billion, which permits borrowing on a secured basis by the Parent Company, BSSC, BSIL and certain other subsidiaries. The Facility also allows the Parent Company, BSIL and Bear Stearns International Trading Limited ("BSIT") to borrow up to \$4.0 billion of the Facility on an unsecured basis. Secured borrowings can be collateralized by both investment-grade and non-investment-grade financial instruments as the Facility provides for defined advance rates on a wide range of financial instruments eligible to be pledged. The Facility contains financial covenants, the most significant of which require maintenance of specified levels of stockholders' equity of the Company and net capital of BSSC. The Facility terminates in February 2008, with all loans outstanding at that date payable no later than February 2009. The Company intends to renew the Facility at market available terms. There were no borrowings outstanding under the Facility at November 30, 2007.

The Company has a \$1.5 billion committed revolving securities repo facility ("Repo Facility"), which permits borrowings secured by a broad range of collateral under a repurchase arrangement by the Parent Company, BSIL, BSIT and BSB and BS Forex. The Repo Facility contains financial covenants that require, among other things, maintenance of specified levels of stockholders' equity of the Company. The Repo Facility terminates in August 2008, with all repos outstanding at that date payable no later than August 2009. There were no borrowings outstanding under the Repo Facility at November 30, 2007.

The Company has a \$350 million committed revolving credit facility ("Pan Asian Facility"), which permits borrowing on a secured basis by the Parent Company, BSSC, Bear Stearns Japan Limited ("BSJL"), and BSIL. The Pan Asian Facility contains financial covenants that require, among other things, maintenance of specified levels of stockholders' equity of the Company and net capital of BSSC. In December 2007, the Company renewed the Facility at a \$350 million committed level with substantially the same terms. The Pan Asian Facility terminates in December 2008 with all loans outstanding at that date payable no later than December 2009. There were no borrowings outstanding under the Pan Asian Facility at November 30, 2007.

The Company has a \$450 million committed revolving credit facility ("Tax Lien Facility"), which permits borrowing on a secured basis by the Parent Company, Plymouth Park Tax Services and Madison Tax Capital LLC. The Tax Lien Facility contains financial covenants that require, among other things, maintenance of specified levels of stockholders' equity of the Company. The Tax Lien Facility terminates in March 2008 with all loans outstanding at that date payable no later than March 2009. There were no borrowings outstanding under the Tax Lien Facility at November 30, 2007.

The Company also maintains a series of committed credit facilities, which permit borrowing on a secured basis, to support liquidity needs for the financing of investment-grade and non-investment-grade corporate loans, residential mortgages, commercial mortgages, listed options and whole loans. The facilities are expected to be drawn from time to time and expire at various dates, the longest of such periods ending in fiscal 2008. All of these facilities contain a term-out option of one year or more for borrowings outstanding at expiration. The banks providing these facilities are committed to provide up to an aggregate of approximately \$6.7 billion. At November 30, 2007, the borrowings outstanding under these committed credit facilities were \$4.9 billion.

## 9. LONG-TERM BORROWINGS

The Company's long-term borrowings (which have original maturities of at least 12 months) at November 30, 2007 and 2006 consisted of the following:

(in billions)	2007	2006
-----		
Fixed-rate notes due 2008 to 2047:		
U.S. dollar-denominated (1) (2)	\$ 19.8	\$ 15.3
Non-U.S. dollar-denominated	8.9	7.3
Floating rate notes due 2008 to 2046:		
U.S. dollar-denominated	21.9	16.5
Non-U.S. dollar-denominated	9.4	6.7
Index/equity/credit-linked notes:		
U.S. dollar-denominated	2.5	2.8
Non-U.S. dollar-denominated	6.0	6.0
-----		
Total long-term borrowings	\$ 68.5	\$ 54.6
=====		

Amounts include fair value adjustments in accordance with SFAS No. 133, hybrid financial instruments accounted for at fair value as elected under SFAS No. 155, as well as \$263 million of junior subordinated deferrable interest debentures ("Debentures"). The Debentures will mature on May 15, 2031; however, effective May 15, 2006, the Company, at its option, may redeem the Debentures. The Debentures are reflected in the table at their contractual maturity dates.

(1) At November 30, 2007 and 2006, U.S. dollar-denominated fixed-rate notes were at interest rates ranging from 2.7% to 7.7% and from 1.0% to 7.5%, respectively.

(2) Included in U.S. dollar-denominated fixed rate notes at November 30, 2007 and 2006 were \$1.0 billion of Subordinated Global Notes due January 22, 2017 that have an annual interest rate of 5.5%, which rank junior in right of payment to all of the Company's senior indebtedness.

The Company has entered into interest rate swaps and other transactions to convert its fixed-rate notes into floating rates based on LIBOR. For floating-rate notes that are not based on LIBOR, the Company has generally entered into interest rate swaps and other transactions to convert them into floating rates based on LIBOR. Index/equity-linked borrowings include various structured instruments whose payments and redemption values are linked to the performance of a specific index (e.g., Dow Jones Industrial Average), a basket of stocks or a specific equity security. To minimize the exposure resulting from movements in the underlying equity position or index, the Company has entered into various equity swap contracts. Credit-linked notes include various structured instruments whose payments and redemption values are linked to the performance of a basket of credit products, an index or an individual security. To minimize exposure to these instruments, the Company has entered into swaps that pay the performance of the underlying security or index.

The effective weighted average interest rates for long-term borrowings, after giving effect to the swaps, were as follows:

	As of November 30,		Fiscal Year Ended November 30,		
	2007	2006	2007	2006	2005
Fixed-rate notes	5.51%	5.77%	5.89%	5.47%	3.59%
Floating-rate notes	5.14%	5.50%	5.57%	5.19%	3.56%

The Company's long-term borrowings at November 30, 2007 mature as follows:

(in millions)	U.S. Dollar			Non-U.S. Dollar			Total
	Fixed Rate	Floating Rate	Index/Equity/Credit Linked	Fixed Rate	Floating Rate	Index/Equity/Credit Linked	
FISCAL YEAR							
2008	\$ 2,367	\$ 5,376	\$ 622	\$ 389	\$ 253	\$ 579	\$ 9,586
2009	799	7,239	794	976	2,258	1,399	13,465
2010	2,976	4,083	321	1,622	395	1,033	10,430
2011	931	2,420	365	1,327	245	1,428	6,716
2012	4,152	1,138	253	1,903	1,446	350	9,242
Thereafter	8,587	1,631	138	2,730	4,852	1,161	19,099
Total	\$19,812	\$21,887	\$2,493	\$8,947	\$9,449	\$5,950	\$68,538

Included in fiscal 2009 are approximately \$996 million of floating-rate notes that are redeemable prior to maturity at the option of the noteholder. These notes contain certain provisions that effectively enable noteholders to put these notes back to the Company and, therefore, are reflected in the table at the date such notes first become redeemable. The final maturity dates of these notes are during fiscal 2009, 2010 and 2011.

Instruments governing certain indebtedness of the Company contain various financial covenants, including maintenance of minimum levels of stockholders' equity of the Company. At November 30, 2007, the Company was in compliance with all covenants contained in these debt agreements.

## 10. PREFERRED STOCK

### PREFERRED STOCK ISSUED BY THE BEAR STEARNS COMPANIES INC.

The Company is authorized to issue a total of 10 million shares of preferred stock at par value of \$1.00 per share. At November 30, 2007, the Company has 1,758,106 shares issued and outstanding under various series as described below. All preferred stock has a dividend preference over the Company's common stock in the paying of dividends and a preference in the liquidation of assets.

The Company has outstanding 3,272,450 depositary shares representing 818,113 shares of Cumulative Preferred Stock, Series E ("Series E Preferred Stock"), having an aggregate liquidation preference of \$164 million as of November 30, 2007. Each depositary share represents a one-fourth interest in a share of Series E Preferred Stock. Dividends on the Series E Preferred Stock are payable at an annual rate of 6.15%. Series E Preferred Stock is redeemable at the option of the Company at any time on or after January 15, 2008, in whole or in part, at a redemption price of \$200 per share (equivalent to \$50 per depositary share), plus accrued but unpaid dividends to the redemption date. During the fiscal year ended November 30, 2007, the Company redeemed and retired 75,800 depositary shares.

The Company has outstanding 1,715,300 depositary shares representing 428,825 shares of Cumulative Preferred Stock, Series F ("Series F Preferred Stock"), having an aggregate liquidation preference of \$86 million as of November 30, 2007. Each depositary share represents a one-fourth interest in a share of Series F Preferred Stock. Dividends on the Series F Preferred Stock are payable at an annual rate of 5.72%. Series F Preferred Stock is redeemable at the option of the Company at any time on or after April 15, 2008, in whole or in part, at a redemption price of \$200 per share (equivalent to \$50 per depositary share), plus accrued but unpaid dividends to the redemption date. During the fiscal year ended November 30, 2007, the Company redeemed and retired 74,900 depositary shares.

The Company has outstanding 2,044,675 depositary shares representing 511,169 shares of Cumulative Preferred Stock, Series G ("Series G Preferred Stock"), having an aggregate liquidation preference of \$102 million as of November 30, 2007. Each depositary share represents a one-fourth interest in a share of Series G Preferred Stock. Dividends on the Series G Preferred Stock are payable at an annual rate of 5.49%. Series G Preferred Stock is redeemable at the option of the Company at any time on or after July 15, 2008, in whole or in part, at a redemption price of \$200 per share (equivalent to \$50 per depositary share), plus accrued but unpaid dividends to the redemption date. During the fiscal year ended November 30, 2007, the Company did not redeem or retire depositary shares.

## **PREFERRED STOCK ISSUED BY SUBSIDIARIES**

Bear Stearns Capital Trust III ("Capital Trust III"), a wholly owned subsidiary of the Company, has issued \$263 million (10,500,000 shares) of Guaranteed Preferred Beneficial Interests in Company Subordinated Debt Securities ("Preferred Securities"). The Preferred Securities are fixed-rate securities, which have a liquidation value of \$25 per security. Holders of the Preferred Securities are entitled to receive quarterly preferential cash distributions at an annual rate of 7.8% through May 15, 2031. The proceeds of the issuance of the Preferred Securities were used to acquire junior subordinated deferrable interest debentures ("Debentures") issued by the Company. The Debentures have terms that correspond to the terms of the Preferred Securities and are the sole assets of Capital Trust III. The Preferred Securities will mature on May 15, 2031. Effective May 15, 2006, the Preferred Securities became redeemable at the Company's option at their principal amounts plus accrued distributions.

In accordance with FIN No. 46 (R), the Company has deconsolidated Capital Trust III. As a result, the Debentures issued by the Company to Capital Trust III are included within long-term borrowings at November 30, 2007 and 2006. The \$263 million of Preferred Securities issued by Capital Trust III are still outstanding, providing the funding for such Debentures. The Preferred Securities issued by Capital Trust III are no longer included in the Company's Consolidated Statements of Financial Condition.

## **11. EARNINGS PER SHARE**

Basic EPS is computed by dividing net income applicable to common shares, adjusted for costs related to vested shares under the CAP Plan, as well as the effect of the redemption of preferred stock, by the weighted average number of common shares outstanding. Common shares outstanding includes vested units issued under certain stock compensation plans, which will be distributed as shares of common stock. Diluted EPS includes the determinants of Basic EPS and, in addition, gives effect to dilutive potential common shares related to stock compensation plans.

The computations of Basic and Diluted EPS for the fiscal years ended November 30, 2007, 2006 and 2005 are set forth below:

(in millions, except per share amounts)	2007	2006	2005
Net income	\$ 233	\$ 2,054	\$ 1,462
Preferred stock dividends	(21)	(21)	(24)
Income adjustment (net of tax) applicable to deferred compensation arrangements-vested shares	7	47	50
Net earnings used for basic EPS	219	2,080	1,488
Income adjustment (net of tax) applicable to deferred compensation arrangements-non-vested shares	4	41	32
Net earnings used for diluted EPS	\$ 223	\$ 2,121	\$ 1,520
Total basic weighted average common shares outstanding (1)	130	132	130
Effect of dilutive securities:			
Employee stock options	5	6	4
CAP and restricted units	11	11	13
Dilutive potential common shares	16	17	17
Weighted average number of common shares outstanding and dilutive potential common shares	146	149	147
Basic EPS	\$ 1.68	\$ 15.79	\$ 11.42
Diluted EPS	\$ 1.52	\$ 14.27	\$ 10.31

(1) Includes approximately 13 million, 13 million and 18 million vested units for the fiscal years ended November 30, 2007, 2006 and 2005, respectively, issued under certain employee stock compensation plans, which will be distributed as shares of common stock.

## 12. EMPLOYEE BENEFIT PLAN

The Company has a qualified non-contributory profit sharing plan covering substantially all employees. Contributions are made at the discretion of management in amounts that relate to the Company's level of income before provision for income taxes. The Company's expense related to the profit sharing plan for the fiscal years ended November 30, 2007, 2006 and 2005 was \$3 million, \$45 million and \$37 million, respectively.

## 13. STOCK COMPENSATION PLANS

The Company has various stock compensation plans designed to increase the emphasis on stock-based incentive compensation and align the compensation of its key employees with the long-term interests of stockholders. As discussed in Note 1, "Summary of Significant Accounting Policies," effective December 1, 2005, the Company adopted SFAS No. 123 (R) using the modified prospective application method. Stock-based compensation cost is measured at grant date, based on the fair value of the award and is recognized as expense over the requisite service period. Beginning in fiscal 2007, the requisite service period was changed to align with the vesting schedule for the Company's stock-based incentive plans (in line with industry practice and the Company's retention strategy). As a result of this change, compensation cost for fiscal 2007 was less than the amount that would have been recognized had the Company not changed the requisite service period. The compensation cost that has been charged against income for the Company's stock compensation plans was \$30 million, \$848 million and \$650 million for the fiscal years ended November 30, 2007, 2006 and 2005, respectively. The total income tax benefit recognized in the income statement for stock-based compensation arrangements was \$13 million, \$357 million and \$273 million for fiscal years ended November 30, 2007, 2006 and 2005, respectively.

The Company concluded that under SFAS No. 123 (R), the grant date for stock-based compensation awards is the date the awards are approved by the Company's Compensation Committee. The Compensation Committee approved the 2007 stock-based compensation awards in December 2007 following the end of the Company's 2007 fiscal year. In years prior to fiscal 2006, stock-based compensation granted in December was included in stockholders' equity at November year end. The Company's stock-based compensation plans are summarized below.

## **STOCK REPURCHASE PROGRAM**

The Company intends to offset the potentially dilutive impact of the annual grants by purchasing common stock throughout the year in open market and private transactions. On December 13, 2006, the Board of Directors of the Company approved an amendment to the Stock Repurchase Program ("Repurchase Program") to replenish the previous authorization in order to allow the Company to purchase up to \$2.0 billion of common stock in fiscal 2007 and beyond. In addition, on September 18, 2007, the Board of Directors approved an amendment to the Repurchase Program authorizing the purchase of up to \$2.5 billion of common stock in fiscal 2007 and beyond. The amendment supersedes the previous \$2.0 billion authorization. The Company expects to utilize the repurchase authorization to offset the dilutive impact of annual share awards. The Company may, depending upon price and other factors, repurchase additional shares in excess of that required for annual share awards. The Company's policy is to issue shares out of treasury upon share option exercise or share unit conversion.

## **CAPITAL ACCUMULATION PLAN**

Pursuant to the CAP Plan, certain key executives receive a portion of their total annual compensation in the form of CAP units. The number of CAP units credited is a function of the dollar amount awarded to each participant and the closing fair market value of the Company's common stock on the date the award is granted. The CAP units awarded under the CAP Plan are subject to vesting and convert to common stock after five years. CAP units granted in each of the periods presented contain selling restrictions subsequent to the vesting date. Holders of CAP units may forfeit ownership of a portion of their award if employment is terminated before the end of the vesting period. The total number of CAP units that may be issued under the CAP Plan during any fiscal year may not exceed 15% of the sum of issued and outstanding shares of common stock and CAP units outstanding determined as of the last day of the current fiscal year.

Beginning with the December 2007 grant, the Company measured compensation cost based on the market price of the Company's common stock on grant date less a discount for post-vesting restrictions. The discount of approximately 5% - 6% per year, was derived based on short forward hedging models and market based pricing as well as academic research. For CAP units granted prior to December 2007, the Company measured compensation cost based on the market value of the Company's common stock at the grant date.

Each CAP unit gives the participant an unsecured right to receive, on an annual basis, an amount equal to the Company's pre-tax income per share, as defined by the CAP Plan, less net income per share, as defined by the CAP Plan, plus dividends per share ("earnings adjustment"), subject to certain limitations. The earnings adjustment will be credited to each participant's deferred compensation account in the form of additional CAP units, based on the number of CAP units in such account at the end of each fiscal year. The number of CAP units credited depends on the amount awarded to each participant and the average per share cost of common stock acquired by the Company. On completion of the five-year deferral period, participants are entitled to receive shares of common stock equal to the number of CAP units then credited to their respective deferred compensation accounts. Amounts recognized attributable to CAP units with respect to the earnings adjustment are recorded in "Other Expenses" in the Consolidated Statements of Income.

Beginning with the December 2007 grant, the requisite service period was changed to align with the vesting schedule for the CAP units and, as a result, there was no expense associated with the 2007 grants. During the fiscal years ended November 30, 2006 and 2005, the Company expensed \$545 million and \$363 million, respectively, attributable to CAP units granted to participants for each of those years. In addition, during the fiscal years ended November 30, 2007, 2006 and 2005, the Company recognized expense of \$18 million, \$154 million and \$144 million, respectively, attributable to CAP units with respect to the earnings adjustment. Awards allocated pursuant to the CAP Plan are credited to participants' deferred compensation accounts in the form of CAP units and are included in stockholders' equity. During the fiscal years ended November 30, 2007, 2006 and 2005, the Company recognized total compensation expense, net of forfeitures, related to the CAP plan, of (\$25) million, \$528 million and \$353 million, respectively.

For awards granted in December 2007, there was \$426 million of total unrecognized compensation cost related to these awards, which is expected to be amortized over a weighted average period of approximately 2.3 years.

## **RESTRICTED STOCK UNIT PLAN**

The Restricted Stock Unit Plan ("RSU Plan") provides for a portion of certain key employees' compensation to be granted in the form of restricted stock units ("RSUs"), with allocations made to participants' deferred compensation accounts. Under the RSU Plan, RSUs granted to employees generally vest over three years and generally convert to common stock within four years. Such units are restricted from sale, transfer or assignment until the end of the restriction period. RSUs granted in each of the periods presented contain selling restrictions subsequent to the vesting date. Holders of RSUs generally may forfeit ownership of a portion of their award if employment is terminated before the end of the vesting period. Holders of RSUs are entitled to receive a dividend in the form of additional RSUs, based on dividends declared on the Company's common stock. The total number of RSUs that may be granted under the RSU Plan may not exceed 25,000,000. As of November 30, 2007, the total number of RSUs outstanding was 6,725,447.

Beginning with the December 2007 grant, the Company measured the compensation cost based on the market price of the Company's common stock on grant date less a discount for post-vesting restrictions. The discount of approximately 5% - 6% per year, was derived based on short forward hedging models and market based pricing as well as academic research. For RSUs granted prior to December 2007, the Company measured compensation cost based on the market value of the Company's common stock at the grant date.

During the fiscal years ended November 30, 2007, 2006 and 2005, the Company recognized compensation expense of \$19 million, \$201 million and \$135 million, respectively, related to awards granted to participants in each of those years. During the fiscal years ended November 30, 2007, 2006 and 2005, the Company recognized total compensation expense related to the RSU Plan of \$46 million, \$218 million and \$174 million, respectively.

As of November 30, 2007, there was \$186 million of total unrecognized compensation cost related to stock-based compensation granted under the RSU Plan which is expected to be recognized over a weighted average period of approximately 3.3 years. For awards granted in December 2007, \$176 million of unrecognized compensation cost related to these awards is expected to be recognized over a weighted average period of approximately 3.1 years.

## **STOCK AWARD PLAN**

Pursuant to the Stock Award Plan, certain key employees are given the opportunity to acquire common stock through the grant of options. Stock options generally have a 10-year expiration. The total number of stock options that may be issued under the Stock Award Plan may not exceed 45,000,000. As of November 30, 2007, the total number of stock options under the Stock Award Plan outstanding was 19,390,856.

The Company awarded approximately \$3 million, \$89 million and \$108 million of employee stock options in fiscal 2007, 2006 and 2005, respectively, of which approximately \$1 million, \$89 million and \$99 million were expensed in fiscal 2007, 2006 and 2005, respectively. Unvested awards granted are expensed over the future vesting periods, generally over three years. In fiscal 2007, 2006 and 2005, the Company recognized total compensation expense related to stock options of \$10 million, \$102 million and \$123 million, respectively.

Fair value was estimated at grant date based on a modified Black-Scholes option-pricing model. The weighted average fair value of options granted relating to the fiscal years ended November 30, 2007, 2006 and 2005 was \$24.03, \$45.83 and \$26.50 per option, respectively. These amounts reflect adjustments for vesting requirements and potential maturity shortening. Estimates of fair value are not intended to predict the value ultimately realized by employees who receive equity awards and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by the Company.

The total intrinsic value of options exercised during the years ended November 30, 2007, 2006 and 2005 was \$151 million, \$247 million and \$149 million, respectively. The total cash received from employees as a result of stock option exercises for the years ended November 30, 2007, 2006 and 2005 was approximately \$162 million, \$290 million and \$202 million, respectively. In connection with these exercises, the tax benefits realized by the Company for the years ended November 30, 2007, 2006 and 2005 were \$55 million, \$90 million and \$59 million, respectively.

The grant date fair value was estimated based on a modified Black-Scholes option pricing model using the following assumptions:

	2007	2006	2005
Risk-free interest rate(1)	3.58%	4.57%	4.46%
Expected option life(2)	5 years	5 years	5 years
Expected stock price volatility(3)	28%	26%	21%
Dividend yield	1.42%	0.68%	0.90%

(1) Represents the interest rate of the five-year U.S. Treasury note.

(2) The expected option life is the number of years that the Company estimates, based on history, that options will be outstanding prior to exercise or forfeiture.

(3) The Company's estimates of expected volatility are principally based on implied volatility of the Company's common stock and other relevant factors.

#### **NON-EMPLOYEE DIRECTORS' STOCK OPTION AND STOCK UNIT PLAN**

Pursuant to the Non-Employee Directors' Stock Option and Stock Unit Plan ("Directors' Plan"), members of the Board of Directors of the Company who are not employees of the Company or any of its subsidiaries ("Non-Employee Directors") may be granted stock options or RSUs. Non-Employee Directors may elect to exchange a portion of their annual cash retainer paid by the Company for services rendered as a director, for stock options or RSUs. Stock options and RSUs issued under the plan generally vest six months after the date of issuance and stock options have a 10-year expiration. The total number of stock options and RSUs combined that may be issued under the Directors' Plan may not exceed 300,000. As of November 30, 2007, the total number of stock options and RSUs outstanding was 101,580, and 24,674, respectively. During the fiscal years ended November 30, 2007, 2006 and 2005, the Company recognized expense of \$0.3 million, \$2 million and \$1 million, respectively, related to these awards.

## SUMMARY OF ALL STOCK UNIT AND OPTION ACTIVITY

The following is a summary of CAP units and RSUs outstanding:

	CAP Units	Weighted Average Fair Value	RSUs	Weighted Average Fair Value
Balance, November 30, 2006	18,525,655	\$ 86.49	6,976,588	\$ 87.63
Granted(1)	3,412,043	\$ 164.82	2,041,497	157.21
Forfeited	(190,910)	\$ 139.91	(368,660)	110.37
Distributed	(3,557,908)	\$ 67.68	(1,899,304)	68.30
Balance, November 30, 2007	18,188,880	\$ 104.34	6,750,121	112.53

(1) The weighted average grant-date fair value for CAP units and RSUs combined was \$161.87, \$132.01 and \$112.01 for fiscal years ended November 30, 2007, 2006 and 2005.

Note: In December 2007, the Company granted 6,093,917 and 1,992,257 CAP units and RSUs, respectively, at an average market price of \$89.95. In addition, in December 2007, 3,996,173 and 1,497,992 CAP units and RSUs, respectively, were converted into common shares and distributed to participants. The award grants and distributions made in December 2007 are not reflected in the table above.

Activity with respect to stock options for the fiscal year ended November 30, 2007 is presented below:

	Number of Shares	Weighted Average Exercise Price
Beginning balance	19,840,381	\$ 78.39
Granted	1,907,803	\$ 164.92
Exercised	(2,153,989)	\$ 74.42
Forfeited	(101,759)	\$ 134.22
Ending balance	19,492,436(1)	\$ 86.75

Note: In December 2007, the Company granted 34,807 options with an exercise price of \$89.95. These option grants are not reflected in the table above.

(1) At November 30, 2007, 18,303,886 stock options were exercisable with a weighted average exercise price of \$85.22 and had an average remaining contractual life of 5.9 years. The aggregate intrinsic value for options outstanding and options exercisable as of November 30, 2007 was \$432.0 million and \$431.9 million respectively.

Information for the Company's stock options as of November 30, 2007 is presented in the following table:

Options Outstanding			
Range of Exercise Prices	Number Outstanding	Weighted Average Exercise Price	Average Remaining Contractual Life (Years)
\$35.00-\$49.99	3,271,833	\$47.17	2.8
\$50.00-\$64.99	4,415,195	\$60.40	4.5
\$65.00-\$79.99	3,325,440	\$73.73	6.0
\$80.00-\$94.99	19,764	\$87.82	6.6
\$95.00-\$109.99	3,486,580	\$102.63	7.1
\$110.00-\$124.99	3,082,553	\$116.50	8.1
\$125.00-\$139.99	30,886	\$136.23	6.5
\$140.00-\$166.00	1,860,185	\$164.94	8.9
Total	19,492,436	\$86.75	5.9

## 14. CUSTOMER ACTIVITIES

### **CUSTOMER CREDIT RISKS**

The Company's clearance activities for both clearing clients and customers (collectively, "customers"), involve the execution, settlement and financing of customers' securities and futures transactions. Customers' securities activities are transacted on either a cash or margin basis, while customers' futures transactions are generally transacted on a margin basis subject to exchange regulations.

In connection with the customer clearance activities, the Company executes and clears customer transactions involving the short sale of securities ("short sales"), entering into futures transactions and the writing of option contracts. Short sales require the Company to borrow securities to settle customer short sale transactions and, as such, these transactions may expose the Company to loss if customers are unable to fulfill their contractual obligations and customers' collateral balances are insufficient to fully cover their losses. In the event customers fail to satisfy their obligations, the Company may be required to purchase financial instruments at prevailing market prices in order to fulfill the customers' obligations.

The Company seeks to control the risks associated with its customers' activities by requiring customers to maintain margin collateral in compliance with various regulatory and internal guidelines. The Company monitors required margin levels and, pursuant to such guidelines, may require customers to deposit additional cash or collateral, or to reduce positions, when deemed necessary. The Company also establishes credit limits for customers engaged in futures activities and monitors credit compliance. Additionally, with respect to the Company's correspondent clearing activities, introducing correspondent firms generally guarantee the contractual obligations of their customers. Further, the Company seeks to reduce credit risk by entering into netting agreements with customers, which permit receivables and payables with such customers to be offset in the event of a customer default.

In connection with the Company's customer financing and securities settlement activities, the Company may pledge customers' securities as collateral to satisfy the Company's exchange margin deposit requirements or to support its various secured financing sources such as bank loans, securities loaned and repurchase agreements. In the event counterparties are unable to meet their contractual obligations to return customers' securities pledged as collateral, the Company may be exposed to the risk of acquiring the securities at prevailing market prices to satisfy its obligations to such customers. The Company seeks to control this risk by monitoring the market value of securities pledged and by requiring adjustments of collateral levels in the event of excess exposure. Moreover, the Company establishes credit limits for such activities and monitors credit compliance.

### **CONCENTRATIONS OF CREDIT RISKS**

The Company is engaged in providing securities processing services to a diverse group of individuals and institutional investors, including affiliates. A substantial portion of the Company's transactions is collateralized and is executed with, or made on behalf of, institutional investors, including other brokers and dealers, commercial banks, insurance companies, pension plans, mutual funds, hedge funds and other financial institutions. The Company's exposure to credit risk, associated with the nonperformance of customers in fulfilling their contractual obligations pursuant to securities and futures transactions, can be directly affected by volatile or illiquid trading markets, which may impair customers' ability to satisfy their obligations to the Company. The Company attempts to minimize credit risk associated with these activities by monitoring customers' credit exposure and collateral values and requiring, when deemed necessary, additional collateral to be deposited with the Company.

From time to time, the Company enters into large financing commitments. During fiscal 2007, the Company led a syndicate that underwrote a large commercial mortgage loan to finance the acquisition of Hilton Hotels Corporation by certain affiliates of The Blackstone Group L.P. including Blackstone Real Estate Partners VI, L.P. as well as certain minority investors. As of November 30, 2007, the Company had advanced approximately \$4.6 billion. The Company has sold a portion of the loan and intends to further reduce its remaining position.

In the ordinary course of business, the company manages the risk of derivatives and other businesses through dealer-to-dealer transactions with other large, highly rated global financial institutions. As a result, the Company is exposed to risk of non-performance on counterparty contracts with such dealers. The Company seeks to mitigate risk of loss through independent assessment of the financial condition of dealers and the collection of collateral to fully or partially secure exposure on a mark-to-market basis. Nonetheless, periods of severe volatility and illiquidity expose the market to potential systemic stress and heightened exposure and risk of default of one or more counterparties.

The Company has entered into a variety of transactions and acquired inventory positions that rely in part on financial guaranties provided by monoline credit insurance entities. The Company's exposure to one such entity, resulting from the purchase of credit default protection on structured asset-backed and corporate credit positions, was fully reserved as of November 30, 2007. In general, the Company has limited its unsecured credit extensions to monoline insurance counterparties. As a result, the Company's direct exposure to non-performance by any of the remaining large monoline insurance companies is not material.

A significant portion of the Company's securities processing activities includes clearing transactions for hedge funds, brokers and dealers and other professional traders, including affiliates. Due to the nature of these operations, which may include significant levels of credit extension such as leveraged purchases, short selling and option writing, the Company may incur credit exposure should these customers be unable to meet their commitments. In addition, the Company may be subject to concentration risk through providing margin to those customers holding large positions in certain types of securities, securities of a single issuer, including sovereign governments, issuers located in a particular country or geographic area or issuers engaged in a particular industry, where the Company receives such large positions as collateral. The Company seeks to control these risks by monitoring margin collateral levels for compliance with both regulatory and internal guidelines. Additional collateral is obtained when necessary. To further control these risks, the Company has developed automated risk control systems that analyze the customers' sensitivity to major market movements. The Company will require customers to deposit additional margin collateral, or to reduce positions if it is determined that customers' activities may be subject to above-normal market risk.

The Company acts as a clearing broker for substantially all of the customer and proprietary securities and futures activities of its affiliates on either a fully disclosed or omnibus basis. Such activities are conducted on either a cash or margin basis. The Company requires its affiliates to maintain margin collateral in compliance with various regulatory guidelines. The Company monitors required margin levels and requests additional collateral when deemed appropriate.

## 15. INCOME TAXES

The Company and certain of its subsidiaries file a U.S. consolidated federal income tax return. The (benefit) provision for income taxes for the fiscal years ended November 30, 2007, 2006 and 2005 consisted of the following:

(in millions)	2007	2006	2005
<b>CURRENT:</b>			
Federal	\$ (72)	\$ 806	\$ 449
State and local	(6)	182	59
Foreign	71	190	124
<b>Total current</b>	<b>(7)</b>	<b>1,178</b>	<b>632</b>
<b>DEFERRED:</b>			
Federal	(81)	(47)	94
State and local	28	(1)	35
Foreign	20	(37)	(16)
<b>Total deferred</b>	<b>(33)</b>	<b>(85)</b>	<b>113</b>
<b>Total (benefit) provision for income taxes</b>	<b>\$ (40)</b>	<b>\$1,093</b>	<b>\$ 745</b>

As of November 30, 2007, the Company had approximately \$1.5 billion in accumulated earnings permanently reinvested overseas. If such income were repatriated, additional federal income tax (net of available tax credits) at current tax rates would be approximately \$303 million.

Significant components of the Company's deferred tax assets (liabilities) as of November 30, 2007 and 2006 were as follows:

(in millions)	2007	2006
<b>DEFERRED TAX ASSETS:</b>		
Deferred compensation	\$ 1,276	\$ 1,213
Liability reserves and valuation adjustments	83	108
Unrealized loss	17	36
Partnerships	202	61
Other	171	170
<b>Total deferred tax assets</b>	<b>1,749</b>	<b>1,588</b>
<b>DEFERRED TAX LIABILITIES:</b>		
Unrealized appreciation	(142)	(43)
Depreciation/amortization	(70)	(67)
Other	(73)	(47)
<b>Total deferred tax liabilities</b>	<b>(285)</b>	<b>(157)</b>
<b>Net deferred tax assets</b>	<b>\$ 1,464</b>	<b>\$ 1,431</b>

At November 30, 2007 and 2006, no valuation allowance has been established against deferred tax assets since it is more likely than not that the deferred tax assets will be realized. Net deferred tax assets are included in "Other Assets" in the Consolidated Statements of Financial Condition.

The Company is estimating state and local net operating loss carryforwards of \$1.18 billion as of November 30, 2007. These carryforwards can be used through November 30, 2028.

The Company is under continuous examination by various tax authorities in jurisdictions in which the Company has significant business operations. The Company regularly assesses the likelihood of additional assessments in each of the tax jurisdictions resulting from these examinations. Tax reserves have been established, which the Company believes to be adequate in relation to the potential for additional assessments. Once established, reserves are adjusted as information becomes available or when an event requiring a change to the reserve occurs. The resolution of tax matters could have a material impact on the Company's effective tax rate.

A reconciliation of the statutory federal income tax rates to the Company's effective tax rates for the fiscal years ended November 30, 2007, 2006 and 2005 was as follows:

	2007	2006	2005
Statutory rate	35.0%	35.0%	35.0%
State and local income taxes, exclusive of effect of legislative changes, net of federal benefit	(9.8)	3.7	2.2
Dividend received deduction	(10.1)	(0.3)	(0.6)
Tax-exempt interest income, net	(14.2)	(0.8)	(1.5)
Lower tax rates applicable to non-U.S. earnings	(31.3)	(1.0)	(0.6)
Domestic tax credits	(17.6)	(0.4)	(0.5)
Effect of legislative changes, net of federal benefit	25.7	-	0.5
Other, net	1.3	(1.5)	(0.7)
Effective tax rate	(21.0)%	34.7%	33.8%

Not included in the effective tax rate is the effect of approximately \$254 million, \$363 million and \$426 million in income tax benefits attributable to the distribution of common stock under the CAP Plan and other deferred compensation plans as well as the exercise of options, credited directly to paid-in capital, for fiscal 2007, 2006 and 2005, respectively.

## 16. REGULATIONS

The Company is regulated by the Securities and Exchange Commission ("SEC") as a consolidated supervised entity ("CSE"). As a CSE, the Company is subject to group-wide supervision and examination by the SEC and is required to compute allowable capital and allowances for market, credit and operational risk on a consolidated basis. As of November 30, 2007, the Company was in compliance with the CSE capital requirements.

Bear Stearns and BSSC are registered broker-dealers and futures commission merchants and, accordingly, are subject to Rule 15c3-1 under the Securities Exchange Act of 1934 ("Net Capital Rule") and Rule 1.17 under the Commodity Futures Trading Commission. Bear Stearns uses Appendix E of the Net Capital Rule ("Appendix E"), which establishes alternative net capital requirements for broker-dealers that are part of consolidated supervised entities. Appendix E allows Bear Stearns to calculate net capital charges for market risk and derivatives-related credit risk based on mathematical models, provided that Bear Stearns holds tentative net capital in excess of \$1 billion and net capital in excess of \$500 million. At November 30, 2007, Bear Stearns' net capital of \$3.60 billion exceeded the minimum requirement by \$3.05 billion. Bear Stearns' net capital computation, as defined, includes \$1.16 billion, which represents net capital of BSSC in excess of 5.5% of aggregate debit items arising from customer transactions.

BSIL and BSIT, London-based broker-dealer subsidiaries, are subject to the regulatory capital requirements of the United Kingdom's Financial Services Authority.

BSB, an Ireland-based bank principally involved in the trading and sales of fixed income products, is registered in Ireland and is subject to the regulatory capital requirements of the Financial Regulator.

Custodial Trust Company ("CTC"), a Federal Deposit Insurance Corporation ("FDIC") insured New Jersey state chartered bank, offers a range of trust, lending, deposit and securities-clearing products and services. CTC provides the Company with banking powers, including access to the securities and funds-wire services of the Federal Reserve System. CTC is subject to the regulatory capital requirements of the FDIC.

At November 30, 2007, Bear Stearns, BSSC, BSIL, BSIT, BSB and CTC were in compliance with their respective regulatory capital requirements. Certain other subsidiaries are subject to various securities regulations and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. At November 30, 2007, these other subsidiaries were in compliance with their applicable local capital adequacy requirements.

Regulatory rules, as well as certain covenants contained in various instruments governing indebtedness of the Company, Bear Stearns and other regulated subsidiaries, may restrict the Company's ability to withdraw capital from its regulated subsidiaries, which in turn could limit the Company's ability to pay dividends. Also, the Company's broker-dealer subsidiaries and other regulated subsidiaries are subject to minimum capital requirements that may restrict the Company's ability to withdraw capital from its regulated subsidiaries, which in turn could limit the Company's ability to pay dividends. At November 30, 2007, approximately \$5.04 billion in equity capital of Bear Stearns, BSSC, BSIL, BSIT, BSB and CTC was restricted as to the payment of cash dividends and advances to the Company.

## 17. COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company has commitments in connection with various activities, the most significant of which are as follows:

### LEASES

The Company occupies office space under leases that expire at various dates through 2024. At November 30, 2007, future minimum aggregate annual rentals payable under non-cancelable leases (net of subleases), including 383 Madison Avenue in New York City, for fiscal years ended November 30, 2008 through 2012 and the aggregate amount thereafter, are as follows:

(in millions)		
-----		
FISCAL YEAR		
2008	\$	125
2009		122
2010		122
2011		133
2012		98
Thereafter		650
-----		
Total		1,250
=====		

The various leases contain provisions for periodic escalations resulting from increased operating and other costs. Rental expense, including escalations and net of sublease rental income, under these leases was \$218 million, \$164 million and \$134 million for the fiscal years ended November 30, 2007, 2006 and 2005, respectively.

### LENDING-RELATED COMMITMENTS

In connection with certain of the Company's business activities, the Company provides financing or financing commitments to investment-grade and non-investment-grade companies in the form of senior and subordinated debt, including bridge financing. Commitments have varying maturity dates and are generally contingent on the accuracy and validity of certain representations, warranties and contractual conditions applicable to the borrower. Lending-related commitments to investment-grade borrowers aggregated approximately \$3.42 billion and \$3.83 billion at November 30, 2007 and 2006, respectively. Of these amounts, approximately \$952 million and \$698 million of the credit risk was offset at November 30, 2007 and 2006, respectively. Lending-related commitments to non-investment-grade borrowers approximated \$3.30 billion and \$2.04 billion at November 30, 2007 and 2006, respectively. Of these amounts, approximately \$220 million and \$89 million of the credit risk was offset at November 30, 2007 and 2006, respectively.

The Company also had contingent commitments to non-investment-grade companies of \$501 million as of November 30, 2007 and contingent commitments to investment grade and non-investment grade companies of \$17.5 billion as of November 30, 2006. Generally, these commitments are provided in connection with leveraged acquisitions. These commitments are not indicative of the Company's actual risk because the borrower may not be successful in the acquisition, the borrower may access the capital markets instead of drawing on the commitment, or the Company's portion of the commitment may be reduced through the syndication process. Additionally, the borrower's ability to draw may be subject to there being no material adverse change in either market conditions or the borrower's financial condition, among other factors. These commitments generally contain certain flexible pricing features to adjust for changing market conditions prior to closing.

## **PRIVATE EQUITY-RELATED INVESTMENTS AND PARTNERSHIPS**

In connection with the Company's merchant banking activities, the Company has commitments to invest in merchant banking and private equity-related investment funds as well as commitments to invest directly in private equity-related investments. At November 30, 2007 and 2006, such commitments aggregated \$729 million and \$788 million, respectively. These commitments will be funded, if called, through the end of the respective investment periods, with the longest of such periods ending in 2020.

## **UNDERWRITING**

In connection with the Company's mortgage-backed securitizations and fixed income and equity underwriting, the Company had commitments to purchase new issues of securities aggregating \$652 million and \$205 million, respectively, at November 30, 2007 and 2006.

## **COMMERCIAL AND RESIDENTIAL LOANS**

The Company participates in the origination, acquisition, securitization, servicing, financing and disposition of commercial and residential loans. At November 30, 2007 and 2006, the Company had entered into commitments to purchase or finance mortgage loans of \$2.83 billion and \$4.23 billion, respectively.

## **LETTERS OF CREDIT**

At November 30, 2007 and 2006, the Company was contingently liable for unsecured letters of credit of approximately \$1.42 billion and \$3.30 billion, respectively, and secured (by financial instruments) letters of credit of \$1.33 billion and \$1.25 billion, respectively. These letters of credit are primarily used to provide collateral for securities borrowed and to satisfy margin requirements at commodity/futures exchanges.

## **ENERGY**

In connection with its energy activities, the Company has entered into contractual obligations (primarily obligations under tolling agreements, net of re-tolling agreements) that require future cash payments. At November 30, 2007, those contractual obligations, by maturity, were as follows:

(in millions)		
-----		
FISCAL YEAR		
2008	\$	81
2009		82
2010		83
2011		258
2012		416
Thereafter		3,399
-----		
Total		4,319
=====		

## **STRATEGIC ALLIANCE**

In October 2007, the Company announced an agreement in principle to form a strategic alliance with CITIC Securities Co. Limited ("CITIC"). The companies will work together to develop new financial products and services to meet the evolving needs of the Chinese market. This alliance will include sharing management expertise and technology to develop new capital markets products and businesses in China, establishing an exclusive joint venture combining the existing businesses of both companies in the rest of Asia, and cross-investments of approximately \$1 billion in each firm by the other. The Company and CITIC have agreed to negotiate with each other on an exclusive basis. The proposed transactions are subject to the negotiation of definitive agreements, the approval by the respective boards of directors of the Company and CITIC, and various governmental and regulatory approvals. There can be no assurances that the Company and CITIC will be able to successfully complete negotiations or consummate the transaction.

## **OTHER**

The Company had commitments to purchase Chapter 13 and other credit card receivables of \$170 million and \$96 million respectively, at November 30, 2007 and 2006.

With respect to certain of the commitments outlined above, the Company utilizes various hedging strategies to actively manage its market, credit and liquidity exposures. Additionally, since these commitments may expire unused, the total commitment amount may not necessarily reflect the actual future cash funding requirements.

## **LITIGATION**

The Company is the sole defendant in an action commenced in the United States Bankruptcy court for the Southern District of New York by the Chapter 11 Trustee for Manhattan Investment Fund Limited ("MIFL"). The complaint seeks to recover from the Company, among other things, certain allegedly fraudulent transfers made by MIFL in the amount of \$141 million plus pre-judgment interest. The Company provided prime brokerage services to MIFL prior to its bankruptcy. In January 2007, the Bankruptcy Court granted the Trustee's motion for summary judgment on the fraudulent transfer claims against the Company. The Company believes it has substantial defenses to the Trustee's claims and intends to appeal the decision of the Bankruptcy Court.

On appeal, the District Court affirmed the Bankruptcy Court's findings in part, but also reversed in part, the Bankruptcy's Court's grant of summary judgment to the Trustee, finding that a trial is necessary to make a factual finding as to whether the Company acted in good faith with respect to its receipt of the alleged fraudulent transfers.

The Company and certain subsidiaries have been named as defendants in various investor lawsuits and FINRA arbitrations relating to the failure of the Bear Stearns High Grade Structured Credit Strategies Master Fund, Ltd (the "High Grade Fund") and the Enhanced Leverage Master Fund, Ltd. (the "Enhanced Leverage Fund"), which were managed by Bear Stearns Asset Management. The High Grade Fund had net investor contributions of approximately \$775 million. The Enhanced Fund had net investor contributions of approximately \$1.08 billion. The relief being sought by the plaintiffs in these matters includes specified and unspecified damages, costs and fees. The Company believes it has substantial defenses to the claims asserted against it in these proceedings. Additionally, the Company and its subsidiaries have been the subject of various state and federal regulatory and law enforcement inquiries, and a state administrative proceeding, relating to the Funds.

In the normal course of business, the Company has been named as a defendant in various legal actions, including arbitrations, class actions and other litigation. Certain of the legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. The Company is also involved in other reviews, investigations and proceedings by governmental and self-regulatory agencies regarding the Company's business, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

Because litigation is inherently unpredictable, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss related to such matters, how such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief might be. Consequently, the Company cannot estimate losses or ranges of losses for matters where there is only a reasonable possibility that a loss may have been incurred. Although the ultimate outcome of these matters cannot be ascertained at this time, it is the opinion of management, after consultation with counsel, that the resolution of the foregoing matters will not have a material adverse effect on the financial condition of the Company, taken as a whole; such resolution may, however, have a material effect on the operating results in any future period, depending on the level of income for such period.

The Company has provided reserves for such matters in accordance with SFAS No. 5, "Accounting for Contingencies." The ultimate resolution may differ materially from the amounts reserved.

## TAX

The Company is under continuous examination by various tax authorities in jurisdictions in which the Company has significant business operations. The Company regularly evaluates the likelihood of additional assessments in each of the tax jurisdictions resulting from these examinations. Tax reserves have been established, which the Company believes to be adequate in relation to the potential for additional assessments. Once established, reserves are adjusted as information becomes available or when an event requiring a change to the reserve occurs.

## 18. GUARANTEES

In the ordinary course of business, the Company issues various guarantees to counterparties in connection with certain derivative, leasing, securitization and other transactions. FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" requires the Company to recognize a liability at the inception of certain guarantees and to disclose information about its obligations under certain guarantee arrangements.

The guarantees covered by FIN No. 45 include contracts that contingently require the guarantor to make payments to the guaranteed party based on changes related to an asset, a liability or an equity security of the guaranteed party, contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an agreement and indirect guarantees of the indebtedness of others, even though the payment to the guaranteed party may not be based on changes to an asset, liability or equity security of the guaranteed party. In addition, FIN No. 45 covers certain indemnification agreements that contingently require the guarantor to make payments to the indemnified party, such as an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law.

The following table sets forth the maximum payout/notional amounts associated with the Company's guarantees as of November 30, 2007:

### Amount of Guarantee Expiration Per Period

(in millions)	Less Than One Year	One to Three Years	Three to Five Years	Greater than Five Years	Total
Certain derivative contracts (notional) (1)	\$ 495,124	\$ 472,384	\$ 742,138	\$ 806,319	\$ 2,515,965
Municipal securities	3,370	502	-	-	3,872
Residual value guarantee	-	-	570	-	570

(1) The gross carrying value of these derivatives approximated \$59.6 billion as of November 30, 2007.

## **DERIVATIVE CONTRACTS**

The Company's dealer activities cause it to make markets and trade a variety of derivative instruments. Certain derivative contracts that the Company has entered into meet the accounting definition of a guarantee under FIN No. 45. Derivatives that meet the FIN No. 45 definition of guarantees include credit default swaps (whereby a default or significant change in the credit quality of the underlying financial instrument may obligate the Company to make a payment), put options, as well as floors, caps and collars. Since the Company does not track the counterparties' purpose for entering into a derivative contract, it has disclosed derivative contracts that are likely to be used to protect against a change in an underlying financial instrument, regardless of their actual use.

On certain of these contracts, such as written interest rate caps and foreign currency options, the maximum payout cannot be quantified since the increase in interest rates and foreign exchange rates is not contractually limited by the terms of the contracts. As such, the Company has disclosed notional amounts as a measure of the extent of its involvement in these classes of derivatives rather than maximum payout. Notional amounts do not represent the maximum payout and generally overstate the Company's exposure to these contracts.

In connection with these activities, the Company mitigates its exposure to market risk by entering into a variety of offsetting derivative contracts and security positions.

## **MUNICIPAL SECURITIES**

In 1997, the Company established a program whereby it created a series of municipal securities trusts in which it has retained interests. These trusts purchase fixed-rate, long-term, highly rated, insured or escrowed municipal bonds financed by the issuance of trust certificates. Certain of the trust certificates entitle the holder to receive future payments of principal and variable interest and to tender such certificates at the option of the holder on a periodic basis. The Company acts as placement agent and as liquidity provider. The purpose of the program is to allow the Company's clients to purchase synthetic short-term, floating-rate municipal debt that does not otherwise exist in the marketplace. In the Company's capacity as liquidity provider to the trusts, the maximum exposure to loss at November 30, 2007 was approximately \$3.87 billion, which represents the outstanding amount of all trust certificates. This exposure to loss is mitigated by the underlying municipal bonds held by trusts. The underlying municipal bonds in the trusts are either AAA- or AA-rated, insured or escrowed to maturity. Such bonds had a market value, net of related offsetting positions, approximating \$3.77 billion at November 30, 2007.

## **RESIDUAL VALUE GUARANTEE**

The Company has entered into an operating lease arrangement for its world headquarters at 383 Madison Avenue in New York City (the "Synthetic Lease"). Under the terms of the Synthetic Lease, the Company is obligated to make monthly payments based on the lessor's underlying interest costs. The Synthetic Lease expires on August 10, 2012 unless both parties agree to a renewal prior to expiration. At the expiration date of the Synthetic Lease, the Company has the right to purchase the building for the amount of the then outstanding indebtedness of the lessor or to arrange for the sale of the property with the proceeds of the sale to be used to satisfy the lessor's debt obligation. If the sale of the property does not generate sufficient proceeds to satisfy the lessor's debt obligation, the Company is required to fund the shortfall up to a maximum residual value guarantee. As of November 30, 2007, there was no expected shortfall and the maximum residual value guarantee was approximately \$570 million.

## **INDEMNIFICATIONS**

The Company provides representations and warranties to counterparties in connection with a variety of commercial transactions, including certain asset sales and securitizations and occasionally indemnifies them against potential losses caused by the breach of those representations and warranties. To mitigate these risks with respect to assets being securitized that have been originated by third parties, the Company seeks to obtain appropriate representations and warranties from such third-party originators upon acquisition of such assets. The Company generally performs due diligence on assets purchased and maintains underwriting standards for assets originated. The Company may also provide indemnifications to certain counterparties to protect them in the event additional taxes are owed or payments are withheld, due either to a change in or adverse application of certain tax laws. These indemnifications generally are standard contractual terms and are entered into in the normal course of business. Generally, there are no stated or notional amounts included in these indemnifications.

Maximum payout information under these indemnifications is not readily available because of the number, size and lives of these transactions. In implementing this accounting interpretation, the Company reviewed its experience with the indemnifications on these structures. Based on such experience, it is unlikely that these arrangements will have a material impact on the Consolidated Financial Statements of the Company.

## **OTHER GUARANTEES**

The Company is a member of numerous exchanges and clearinghouses. Under the membership agreements, members are generally required to guarantee the performance of other members. Therefore, if a member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet these shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. The Company's maximum potential liability under these arrangements cannot be quantified. However, the potential for the Company to be required to make payments under these arrangements is remote. Accordingly, no contingent liability is recorded in the Consolidated Financial Statements for these arrangements.

## **19. SEGMENT AND GEOGRAPHIC AREA DATA**

The Company operates in three principal segments -- Capital Markets, Global Clearing Services and Wealth Management. These segments offer different products and services and are managed separately as different levels and types of expertise are required to effectively manage the segments' transactions.

The Capital Markets segment is comprised of the institutional equities, fixed income and investment banking areas. The Capital Markets segment operates as a single integrated unit that provides the sales, trading and origination effort for various fixed income, equity and advisory products and services. Each of the three businesses work in tandem to deliver these services to institutional and corporate clients.

Institutional equities consists of sales, trading and research, in areas such as domestic and international equities, block trading, over-the-counter equities, equity derivatives, energy and commodity activities, risk and convertible arbitrage and specialist activities on the NYSE, AMEX and International Stock Exchange. Fixed income includes sales, trading, origination and research provided to institutional clients across a variety of products such as mortgage- and asset-backed securities, corporate and government bonds, municipal bonds, high yield products, including bank and bridge loans, foreign exchange and interest rate and credit derivatives. Investment banking provides services in capital raising, strategic advice, mergers and acquisitions and merchant banking. Capital raising encompasses the Company's underwriting of equity, investment grade, municipal and high yield debt products.

The Global Clearing Services segment provides execution, clearing, margin lending and securities borrowing to facilitate customer short sales to clearing clients worldwide. Prime brokerage clients include hedge funds and clients of money managers, short sellers and other professional investors. Fully disclosed clients engage in either the retail or institutional brokerage business.

The Wealth Management segment is composed of the PCS and asset management areas. PCS provides high-net-worth individuals with an institutional level of investment service, including access to the Company's resources and professionals. Asset management manages equity, fixed income and alternative assets for leading corporate pension plans, public systems, endowments, foundations, multi-employer plans, insurance companies, corporations, families and high-net-worth individuals in the United States and abroad.

The three business segments comprise many business areas, with interactions among each. Revenues and expenses include those that are directly related to each segment. Revenues from intersegment transactions are allocated based upon specific criteria or agreed upon rates with such amounts eliminated in consolidation. Individual segments also include revenues and expenses relating to various items, including corporate overhead and interest, which are internally allocated by the Company primarily based on balance sheet usage or expense levels. The Company generally evaluates performance of the segments based on net revenues and profit or loss before provision for income taxes.

Fiscal Years Ended November 30,	2007	2006	2005
(in millions)			
NET REVENUES			
Capital Markets			
Institutional Equities	\$ 2,158	\$ 1,961	\$ 1,446
Fixed Income	685	4,190	3,293
Investment Banking	1,076	1,170	983
Total Capital Markets	3,919	7,321	5,722
Global Clearing Services	1,200	1,077	1,029
Wealth Management			
Private Client Services (1)	602	522	453
Asset Management	228	336	228
Total Wealth Management	830	858	681
Other (2)	(4)	(29)	(21)
Total net revenues	\$ 5,945	\$ 9,227	\$ 7,411
PRE-TAX INCOME			
Capital Markets	\$ (232) (4)	\$ 2,801	\$ 2,020
Global Clearing Services	566	465	472
Wealth Management	(45)	69	37
Other (3)	(96)	(188)	(322)
Total pre-tax income	\$ 193	\$ 3,147	\$ 2,207
NET INTEREST REVENUES			
Capital Markets	\$ 382	\$ 350	\$ 172
Global Clearing Services	923	803	736
Wealth Management	39	59	57
Other	6	-	-
Total net interest revenues	\$ 1,350	\$ 1,212	\$ 965
(1) Private Client Services detail:			
Gross revenues, before transfer to Capital Markets segment	\$ 710	\$ 620	\$ 547
Revenue transferred to Capital Markets segment	(108)	(98)	(94)
Private Client Services net revenues	\$ 602	\$ 522	\$ 453

(2) Includes consolidation and elimination entries.

(3) Includes certain legal costs and costs related to the CAP Plan, which approximate \$18 million, \$154 million and \$144 million for the fiscal years ended November 30, 2007, 2006, 2005, respectively.

(4) Includes a non-cash charge of \$227 million related to the write-off of intangible assets, representing goodwill and specialist rights associated with our NYSE specialist activities.

As of November 30,	2007	2006	2005
(in billions)			
SEGMENT ASSETS			
Capital Markets	\$ 247	\$ 230	\$ 183
Global Clearing Services	118	109	93
Wealth Management	4	3	3
Other	26	8	8
Total segment assets	\$ 395	\$ 350	\$ 287

The operations of the Company are conducted primarily in the United States of America. The Company also maintains offices in Europe, Asia and Latin America. The following are net revenues, income before provision for income taxes and assets by geographic region for the fiscal years ended November 30, 2007, 2006 and 2005:

(in millions)	2007	2006	2005
Net Revenues-U.S.	\$ 4,219	\$ 8,006	\$ 6,488
Non-U.S.	1,726	1,221	923
Total net revenues	\$ 5,945	\$ 9,227	\$ 7,411
(Loss) Income before provision for income taxes-U.S.	\$ (561)	\$ 2,669	\$ 1,868
Non-U.S.	754	478	339
Total income before provision for income taxes	\$ 193	\$ 3,147	\$ 2,207
Total Assets-U.S.	\$ 480,824	\$ 437,419	\$ 344,758
Non-U.S.	126,507	92,836	70,436
Eliminations	(211,969)	(179,822)	(127,901)
Total assets	\$ 395,362	\$ 350,433	\$ 287,293

Because of the international nature of the financial markets and the resultant integration of U.S. and non-U.S. services, it is difficult to precisely separate foreign operations. The Company conducts and manages these activities with a view toward the profitability of the Company as a whole. Accordingly, the foreign operations information is, of necessity, based on management judgments and internal allocations.

## 20. ACQUISITION OF MINORITY INTEREST AND IMPAIRMENT OF INTANGIBLE ASSETS

At the close of business on April 30, 2007, the Company completed an acquisition of the outstanding minority interest in Bear Hunter Holdings LLC (the parent of Bear Wagner Specialists) from its partner, Hunter Partners LLC.

The Company tests goodwill at least annually for impairment in accordance with SFAS No. 142 by comparing the fair value of a reporting unit with the carrying amount, including goodwill. In addition, the Company amortizes identifiable intangible assets over their estimated useful lives in accordance with SFAS No. 142 and tests for potential impairment whenever events or changes in circumstances suggest that an asset's carrying value may not be fully recoverable in accordance with SFAS No. 144. An impairment loss, calculated as the difference between the estimated fair value and the carrying value of an asset, is recognized if the expected undiscounted cash flows relating to the asset are less than the corresponding carrying value.

During the fourth quarter of fiscal 2006, the New York Stock Exchange introduced its Hybrid trading system, a new electronic trading system designed to make it more competitive. The Hybrid trading system automated certain of the tasks previously performed by specialists and dramatically reduced the opportunity for specialists to participate in the order process. The Company monitored the impact of the introduction of the Hybrid trading system on its specialist business. As a result, during the May 2007 quarter, the Company tested its goodwill and specialist rights associated with its NYSE specialist activities and recognized a non-cash impairment charge of \$227 million relating to the original purchase of Wagner Stott Mercator, LLC in April 2001. The impairment charge is included on a separate line item on the Consolidated Statements of Income and within the Company's Capital Markets segment for the fiscal year ended November 30, 2007.

## 21. ASSET ACQUISITION

On May 20, 2007, Bear Energy L.P., a Houston-based, wholly owned subsidiary of the Company, signed a definitive agreement to acquire substantially all of the power-related and natural gas assets comprising the power trading business of Williams Power Company, Inc., an energy trading and marketing subsidiary of The Williams Companies, Inc. The transaction closed on November 8, 2007 for cash consideration of \$496 million. The purchase price allocation resulted in recording trading assets of \$548 million, intangible assets of \$863 million, and intangible liabilities of \$915 million based on contractual arrangements, at their estimated fair values. As of November 30, 2007, the weighted average amortization period for intangible assets and intangible liabilities was approximately 10.8 years and 13.4 years, respectively. As of November 8, 2007, the results of operations of the power-related assets and liabilities acquired were included in the Company's Capital Markets segment.

The estimated aggregate amortization expense for each of the five succeeding fiscal years for intangible assets and intangible liabilities were as follows:

(in millions)	Intangible Assets		Intangible Liabilities	
FISCAL YEAR	\$		\$	
2008	\$	99	\$	208
2009		98		129
2010		96		98
2011		64		74
2012		50		47
Thereafter		456		359
<b>Total</b>	<b>\$</b>	<b>863</b>	<b>\$</b>	<b>915</b>

## 22. QUARTERLY INFORMATION (UNAUDITED)

The unaudited quarterly results of operations of the Company for the fiscal years ended November 30, 2007 and 2006 are prepared in conformity with accounting principles generally accepted in the United States of America, which include industry practices, and reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results of operations for the periods presented. Results of any interim period are not necessarily indicative of results for a full year.

(in millions, except per share data)	Quarters Ended,				Fiscal Year,
	February 28, 2007	May 31, 2007	August 31, 2007	November 30, 2007	November 30, 2007 (1)
Revenues	\$ 4,798	\$ 4,976	\$ 4,340	\$ 2,038	\$ 16,151
Interest expense	2,316	2,464	3,009	2,417	10,206
Revenues, net of interest expense	2,482	2,512	1,331	(379)	5,945
Non-interest expenses					
Employee compensation and benefits	1,204	1,231	664	326	3,425
Other	443	727	492	666	2,327
Total non-interest expenses	1,647	1,958	1,156	992	5,752
Income (loss) before provision (benefit) for income taxes	835	554	175	(1,371)	193
Provision (benefit) for income taxes	281	192	4	(517)	(40)
Net income (loss)	554	362	171	(854)	233
Basic earnings per share	\$ 4.23	\$ 2.78	\$ 1.30	\$ (6.90)	\$ 1.68
Diluted earnings (loss) per share	\$ 3.82	\$ 2.52	\$ 1.16	\$ (6.90)(2)	\$ 1.52
Cash dividends declared per common share	\$ 0.32	\$ 0.32	\$ 0.32	\$ 0.32	\$ 1.28

(in millions, except per share data)	Quarters Ended,				Fiscal Year,
	February 28, 2006	May 31, 2006	August 31, 2006	November 30, 2006	November 30, 2006 (1)
Revenues	\$ 3,638	\$ 4,304	\$ 4,136	\$ 4,474	\$ 16,551
Interest expense	1,453	1,805	2,007	2,061	7,324
Revenues, net of interest expense	2,185	2,499	2,129	2,413	9,227
Non-interest expenses					
Employee compensation and benefits	1,047	1,220	1,025	1,052	4,343
Other	386	445	437	468	1,737
Total non-interest expenses	1,433	1,665	1,462	1,520	6,080
Income before provision for income taxes	752	834	667	893	3,147
Provision for income taxes	238	295	229	330	1,093
Net income	514	539	438	563	2,054
Basic earnings per share	\$ 3.92	\$ 4.12	\$ 3.34	\$ 4.42	\$ 15.79
Diluted earnings per share	\$ 3.54	\$ 3.72	\$ 3.02	\$ 4.00	\$ 14.27
Cash dividends declared per common share	\$ 0.28	\$ 0.28	\$ 0.28	\$ 0.28	\$ 1.12

(1) Beginning with the fourth quarter of 2007, the Company's results of operations were rounded in \$ millions. Quarterly results prior to the fourth quarter are rounded based on previously disclosed figures. As a result, the sum of the quarterly results of operations may differ from the full fiscal year amounts disclosed on the Company's Consolidated Statement of Income.

(2) Due to the net loss in the fourth quarter of 2007, the diluted earnings per share calculation excludes 15.1 million dilutive potential common shares, as they were anti-dilutive.

## 23. SUBSEQUENT EVENTS

### **BACKGROUND OF THE MERGER**

The Company experienced a significant liquidity crisis during the end of the week of March 10, 2008 that seriously jeopardized its financial viability and which raises substantial doubt about its ability to continue as a going concern. As a result, on March 16, 2008, the Company and JPMorgan Chase & Co. ("JPMorgan Chase") entered into an agreement and plan of merger, and on March 24, 2008, entered into an amendment to the agreement and plan of merger (as amended, the "Merger Agreement"). Pursuant to the Merger Agreement, each share of the Company's common stock outstanding immediately prior to the merger will be exchanged for 0.21753 of a share of JPMorgan Chase common stock. A summary of the Merger Agreement, related transaction documents and the accounting implications are described in more detail in the Transaction Documents and Accounting Implications sections of this note.

In connection with the entry into the amendment to the Merger Agreement, the Company and JPMorgan Chase entered into a share exchange agreement under which JPMorgan Chase will purchase 95 million newly issued shares of the Company's common stock, or 39.5% of the outstanding common stock of the Company after giving effect to the issuance, in exchange for the issuance of 20,665,350 shares of JPMorgan Chase common stock to the Company and the entry by JPMorgan Chase into the amendment to the merger agreement, an amended and restated guaranty agreement and the guaranty agreement with the Federal Reserve Bank of New York (the "New York Fed"). The share exchange was completed on April 8, 2008.

Concurrent with the closing of the merger, the New York Fed will take through a limited liability company formed for this purpose control of a portfolio of \$30 billion in assets of the Company based on the value of the portfolio as of March 14, 2008. The assets will be funded by a \$29 billion, 10-year term loan from the New York Fed, and a \$1 billion, 10-year subordinated note from JPMorgan Chase. The JPMorgan Chase note is subordinated to the New York Fed loan and will bear the first \$1 billion of any losses associated with the assets. Any funds remaining after payment of the New York Fed loan, the JPMorgan Chase note and other expenses of the limited liability company, will be paid to the New York Fed.

### **TRANSACTION DOCUMENTS**

#### **Agreement and Plan of Merger**

Upon the terms and subject to the conditions set forth in the Merger Agreement, a wholly-owned subsidiary of JPMorgan Chase will merge with and into the Company with the Company continuing as the surviving corporation and as a wholly-owned subsidiary of JPMorgan Chase (the "Merger"). At the effective time of the Merger, each share of Company common stock will be converted into the right to receive 0.21753 of a share of JPMorgan Chase common stock. Outstanding Company stock options and phantom stock units will be converted into JPMorgan Chase equity awards, adjusted to reflect the exchange ratio in the Merger. The Company and JPMorgan Chase have agreed to consider providing holders of restricted stock units and capital accumulation plan units with the right to elect, prior to completion of the Merger, to have outstanding awards distributed in cash (rather than stock) at the same time the units would have been settled absent such election, and otherwise subject to the same terms and conditions in the applicable plans and award agreements, as amended.

The Merger Agreement contains representations and warranties of Bear Stearns and JPMorgan Chase relating to their respective businesses. Pursuant to the Merger Agreement, the Company has agreed to operate within its existing credit, principal, market and other risk limits and comply with existing risk-related policies and procedures, subject to JPMorgan Chase's right to oversee the Company's setting and changing of such policies, procedures and limits. Subject to the continued effectiveness of the Guaranty (as defined below), the Company has granted JPMorgan Chase the right to oversee the business, operations and management of the Company in its reasonable discretion. The Company also granted JPMorgan Chase the rights to custody of, and to manage, a scheduled collateral pool and related hedges, which rights were delegated to the New York Fed. Additionally, the Company has agreed not to (i) solicit proposals relating to alternative business combination transactions or (ii) subject to certain exceptions, enter into discussions, or enter into any agreement, concerning, or provide confidential information in connection with, any proposals for alternative business combination transactions.

Consummation of the Merger is subject to the satisfaction of certain conditions including, among other things, (i) approval and adoption of the Merger Agreement by the Company's stockholders; (ii) registration and NYSE listing of the common stock to be issued by JPMorgan Chase in the Merger; (iii) absence of any order, injunction or decree preventing or making illegal the consummation of the Merger; and (iv) receipt of specified governmental and regulatory approvals.

The Merger Agreement contains certain termination rights for both the Company and JPMorgan Chase. In the event the Company's stockholders do not approve and adopt the Merger Agreement at the first stockholders meeting called for that purpose, JPMorgan Chase will have the right to exercise an option to purchase the Company's headquarters building for an amount equal to \$1.1 billion less assumed indebtedness and transfer costs. In addition, JPMorgan Chase will also have the right to exercise such option following the termination of the Merger Agreement under the following circumstances: (i) JPMorgan Chase terminates the Merger Agreement because (A) the Company's board of directors made any change of recommendation, (B) the Company breached its no-solicitation and related obligations under the Merger Agreement, or (C) the Company breached its obligations to hold a meeting of its stockholders to approve and adopt the Merger Agreement, or (ii) (A) JPMorgan Chase or the Company terminate the Merger Agreement because both (x) the approval and adoption of the Merger Agreement by the Company's stockholders has not been obtained and (y) 120 days have elapsed from the date of such stockholders meeting (provided that the parties may mutually agree to extend the 120-day period); (B) JPMorgan Chase terminates the Merger Agreement because there has been an uncured breach by the Company of any of the covenants or agreements or any of the representations or warranties in the Merger Agreement that would cause the failure of the closing conditions set forth in the Merger Agreement to be satisfied; or (C) JPMorgan Chase or the Company terminates the Merger Agreement because the merger has not been consummated on or before the first anniversary of the date of the Merger Agreement, and prior to any termination of the merger agreement described in this clause (ii) an alternative proposal has been publicly announced or otherwise communicated or made known to the Company and has not been irrevocably withdrawn. Upon the exercise of the option to purchase the Company's headquarters building, the Company will, upon the request of JPMorgan Chase, exercise its option to purchase the headquarters building and take all action required to acquire the building and simultaneously convey it to JPMorgan Chase.

The foregoing description of the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is filed as Exhibit 2.1 to the Company's Current Reports on Form 8-K filed on March 20, 2008 and March 24, 2008 (Amendment No. 1).

Beginning March 17, 2008, various stockholders of the Company filed several purported class action lawsuits against the Company, its board of directors and certain of the Company's present and former executive officers. Among other things, these actions allege that the individual defendants breached their fiduciary duties and obligations to the Company's stockholders by agreeing to the proposed merger. Five of these actions have been filed in the Supreme Court of the State of New York and consolidated under the caption *In re Bear Stearns Litigation*. Two actions have been filed in the Delaware Court of Chancery where plaintiffs have filed a motion to consolidate their cases in Delaware. JPMorgan Chase is named as a defendant in certain of these cases. In each of these actions, plaintiffs seek to enjoin the proposed merger and enjoin JPMorgan Chase from voting the 95 million shares acquired pursuant to the Share Exchange Agreement (as defined below), other injunctive relief and an unspecified amount of compensatory damages. On April 9, 2008, the Delaware Chancery Court granted JPMorgan Chase's and the Company's motion to stay the Delaware action in favor of the New York action, at least until the preliminary injunction motion is resolved. The Delaware court also granted plaintiffs' motion to consolidate their cases. Additionally, on April 10, 2008, an amended complaint was filed in a previously-filed shareholder derivative suit naming the Company's directors and certain former and present executive officers. This amended complaint seeks, among other things, a declaration that the Merger Agreement is unlawful, unenforceable, and seeks to enjoin the merger. Although the Company is unable at this time to determine the ultimate outcome of these lawsuits, injunctive relief or an adverse determination could affect the Company's ability to complete the merger.

## **Share Exchange Agreement**

On March 24, 2008, the Company and JPMorgan Chase, in connection with entering into the amendment to the Merger Agreement, entered into a share exchange agreement (the "Share Exchange Agreement"), under which JPMorgan Chase will purchase 95 million newly issued shares of the Company's common stock, or 39.5% of the outstanding shares of the Company's common stock after giving effect to the issuance, in exchange for the issuance of 20,665,350 shares of JPMorgan Chase common stock to the Company and the entry by JPMorgan Chase into the amendment to the merger agreement, an amended and restated guaranty agreement and the guaranty in favor of the New York Fed (each as described below). The share exchange was completed on April 8, 2008.

The foregoing description of the Share Exchange Agreement does not purport to be complete and is qualified in its entirety by reference to the Share Exchange Agreement, which is filed as Exhibit 2.2 to the Company's Current Report on Form 8-K filed on March 24, 2008.

## **Amended and Restated Guaranty Agreement**

On March 24, 2008, JPMorgan Chase, in connection with the amendment to the Merger Agreement, entered into an amended and restated guaranty agreement (the "Guaranty"), effective retroactively from March 16, 2008, which replaces the guaranty agreement entered into on March 16, 2008 in connection with the Merger Agreement. Pursuant to the Guaranty, JPMorgan Chase will guarantee certain liabilities of the Company and certain of its operating subsidiaries (the "Guaranteed Bear Entities") to the extent such liabilities arise prior to the end of the specified "Guaranty Period", including (i) liabilities and obligations under revolving credit facilities, letters of credit and letter of credit facilities, term loan facilities, lines of credit or uncommitted loan facilities, in each case whether secured or unsecured, of the Guaranteed Bear Entities, (ii) brokerage and trading contract obligations of the Guaranteed Bear Entities (including liabilities and obligations arising under prime brokerage agreements and accounts, securities lending agreements, custodial and carrying agreements, securities accounts and securities contracts, commodity contracts, forward contracts, futures contracts, tolling agreements, energy management agreements, repurchase or reverse repurchase agreements, swap agreements, foreign exchange and currency contracts, options or other derivatives, settlement or clearing agreements and arrangements, margin loan agreements, other contracts or transactions similar to any of the foregoing, any customary brokerage commission with respect to the foregoing, any contractual obligation to provide collateral or margin in respect of any of the foregoing or any obligation under a guaranty of any of the foregoing and (iii) obligations of the Guaranteed Bear Entities to deliver cash, securities or other property to customers pursuant to customary custody arrangements. The Guaranty Period will end (subject to provision of further notice by JPMorgan Chase posted on its website at least three days prior to the end of the Guaranty Period), no sooner than the earliest to occur of (i) the date that is 120 days following the failure of the Company's stockholders to approve and adopt the Merger Agreement at a meeting of the Company's stockholders convened for that purpose, (ii) the date that is 120 days following closing of the Merger and (iii) the date of termination of the Merger Agreement.

The foregoing description of the Guaranty does not purport to be complete and is qualified in its entirety by reference to the Guaranty, which is filed as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on March 24, 2008.

## **Guarantee and Collateral Agreement**

On March 24, 2008, JPMorgan Chase, in connection with the amendment to the Merger Agreement and the Guaranty, entered into a guarantee and collateral agreement (the "Guarantee and Collateral Agreement") with the Company and certain of its subsidiaries (collectively, the "Collateral Parties") pursuant to which the Collateral Parties agreed to guarantee the obligations of each of them to repay to JPMorgan Chase (1) any loans or other advances of credit by JPMorgan Chase and its affiliates to the Company and its affiliates and (2) any amounts paid by JPMorgan Chase to creditors of the Company and its affiliates under the Guaranty and the Fed Guarantee (as defined below). Each of the Collateral Parties secured their guarantee by granting a lien on substantially all of their respective assets, subject to certain carve-outs.

The foregoing description of the Guarantee and Collateral Agreement does not purport to be complete and is qualified in its entirety by reference to the Guarantee and Collateral Agreement, which is filed as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on March 28, 2008.

## **Fed Guaranty Agreement**

On March 24, 2008, JPMorgan Chase, in connection with the amendment to the Merger Agreement, entered into a guarantee in favor of the New York Fed (the "Fed Guarantee"), pursuant to which JPMorgan Chase guaranteed certain obligations of the Company and certain of its affiliates to the New York Fed. Such guarantee will apply with respect to transactions entered into prior to the termination of the Merger Agreement and may be terminated by JPMorgan Chase with respect to transactions thereafter.

The foregoing description of the Fed Guaranty does not purport to be complete and is qualified in its entirety by reference to the Fed Guarantee, which is filed as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on March 24, 2008.

## **ACCOUNTING IMPLICATIONS**

Based on the activities discussed above, the following accounting impacts on the consolidated financial statements have occurred or are expected to occur for periods ending after March 10, 2008:

### **Municipal Securities**

The Company acts as placement agent and as liquidity provider under a municipal tender option bond program as described in Note 18, "Guarantees" to the Consolidated Financial Statements of the Company. Under the program, the Company has created a series of municipal securities trusts which purchase fixed-rate, long-term, highly rated, insured or escrowed municipal bonds financed by the issuance of trust certificates. The trust certificates entitle the holder to tender such certificates at the option of the holder on a periodic basis. Subsequent to March 10, 2008, holders of all the Class A trust certificates had tendered such certificates to the Company, resulting in the Company owning 100% of the trusts and consolidation of the trusts. As a result, the Company recognized losses of approximately \$200 million in the second quarter of 2008.

### **Deferred Tax Asset**

As of February 29, 2008, the Company had approximately \$1.5 billion in net deferred tax assets (approximately \$1.3 billion was associated with its stock-based compensation plans). In accordance with SFAS No. 109, the gross deferred tax assets of \$1.7 billion will be evaluated for future realization and be reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Management will be required to make certain estimates and assumptions in order to assess the realizability of the deferred tax assets. Further, full realization of the deferred tax asset for stock-based compensation requires the shares for RSUs and CAP units to be distributed at a price equaling or exceeding the fair value at the grant date. The provisions of SFAS No. 123(R), however, do not allow a valuation allowance to be recorded based on the current fair value of the Company's shares. Accordingly, given the activities discussed above, the Company believes it is likely that a significant portion of this deferred tax asset will not be realized in the future.

## **Goodwill and Intangibles**

As of February 29, 2008, the Company had goodwill and intangible assets. Based on the proposed merger agreement, the Company believes an impairment loss for \$88 million is probable, and would be recorded in the second quarter of 2008.

Since the liquidity crisis and the announcement of the merger, the Company has experienced substantial deterioration of its earnings capacity. The closing of the merger is expected to occur by June 30, 2008. The Company believes that the termination of the JPMorgan Chase guaranties prior to consummation of the merger or the parties' failure to consummate the merger could seriously jeopardize the Company's financial viability. In addition, absent the Guaranty, the Company could face the increased risk of rapid loss of customers and counterparties. The lack of liquidity and the loss of customers and counterparties would materially adversely affect the Company's financial stability and its viability as a going concern. Accordingly, the Company could be forced to file for bankruptcy protection and need to liquidate. The accompanying consolidated financial statements do not reflect any adjustments that might result if the Company were unable to continue as a going concern.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Stockholders of The Bear Stearns Companies Inc.**

We have audited (1) the consolidated financial statements of The Bear Stearns Companies Inc. and subsidiaries (the "Company") as of November 30, 2007 and 2006, and for each of the three years in the period ended November 30, 2007, and have issued our report thereon dated January 28, 2008 (April 11, 2008 as to Note 23)(which report expresses an unqualified opinion and includes explanatory paragraphs referring to substantial doubt about the Company's ability to continue as a going concern, and the adoption of Statement of Financial Accounting Standards ("SFAS") No. 155, "Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140" and SFAS No. 157, "Fair Value Measurements"), such consolidated financial statements and report are included as Exhibit No. 99.1 in this Current Report on Form 8-K; and (2) the Company's internal control over financial reporting as of November 30, 2007, and have issued our report thereon dated January 28, 2008, such report is included in the Company's 2007 Annual Report on Form 10-K for the year ended November 30, 2007. Our audits also included the financial statement schedule (Schedule I) of The Bear Stearns Companies Inc. (Parent Company Only). This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have not audited any consolidated financial statements of the Company for any period subsequent to November 30, 2007, nor have we performed a review of interim financial statements in conformity with the standards of the Public Company Accounting Oversight Board (United States) for any period subsequent to November 30, 2007. However, as referenced in Note 4 to the financial statement schedule and discussed in Note 23 to the consolidated financial statements, during the end of the week of March 10, 2008, the Company experienced a significant liquidity crisis which seriously jeopardized the financial viability of the Company, and which raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regards to these matters are also discussed in Note 23 to the consolidated financial statements. The consolidated financial statements and the financial statement schedule do not include any adjustments that might result from the outcome of this uncertainty.

Effective December 1, 2006, the Company adopted SFAS No. 155, "Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140" and SFAS No. 157, "Fair Value Measurements."

*/s/ Deloitte & Touche LLP*

*New York, New York  
January 28, 2008*

(April 11, 2008 as to Note 4)

**CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
THE BEAR STEARNS COMPANIES INC.  
(PARENT COMPANY ONLY)**

**CONDENSED STATEMENTS OF INCOME**  
(in millions)

Fiscal Years Ended November 30,	2007	2006	2005
	-----	-----	-----
<b>REVENUES</b>			
Interest.....	\$ 4,102	\$ 3,157	\$ 1,233
Other.....	534	195	248
	-----	-----	-----
	4,636	3,352	1,481
	-----	-----	-----
<b>EXPENSES</b>			
Interest.....	4,235	3,387	1,582
Other.....	198	206	196
	-----	-----	-----
	4,433	3,593	1,778
	-----	-----	-----
Income (loss) before benefit from income taxes and equity in earnings of subsidiaries.....	203	(241)	(297)
(Provision for)/benefit from income taxes.....	(160)	20	96
	-----	-----	-----
Income (loss) before equity in earnings of subsidiaries	43	(221)	(201)
Equity in earnings of subsidiaries, net of tax.....	190	2,275	1,663
	-----	-----	-----
Net income.....	\$ 233	\$ 2,054	\$ 1,462
	=====	=====	=====

**See Notes to Condensed Financial Information.**

**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**THE BEAR STEARNS COMPANIES INC.**  
(PARENT COMPANY ONLY)

**CONDENSED STATEMENTS OF FINANCIAL CONDITION**  
(in millions, except share data)

As of November 30,	2007	2006
	-----	-----
<b>ASSETS</b>		
Cash and cash equivalents.....	\$ 17,401	\$ 2,007
Securities purchased under agreements to resell.....	1,409	97
Receivables from subsidiaries.....	47,985	67,185
Subordinated loans receivable from subsidiaries.....	12,948	9,963
Investments in subsidiaries, at equity.....	8,097	7,975
Assets of variable interest entities.....	650	575
Other assets.....	7,587	3,580
	-----	-----
Total Assets.....	\$ 96,077	\$ 91,382
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Unsecured short-term borrowings.....	\$ 8,723	\$ 19,467
Collateralized financings.....	122	--
Payables to subsidiaries.....	6,961	6,573
Liabilities of variable interest entities.....	205	220
Other liabilities and accrued expenses.....	2,345	1,102
	-----	-----
	18,356	27,362
	-----	-----
Commitments and contingencies (Note 1)		
Long-term borrowings.....	65,665	51,628
Long-term borrowings from subsidiaries.....	263	263
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock	352	359
Common stock, \$1.00 par value; 500,000,000 shares authorized as of November 30, 2007 and 2006; 184,805,847 shares issued as of November 30, 2007 and 2006...	185	185
Paid-in capital.....	4,986	4,579
Retained earnings.....	9,441	9,385
Employee stock compensation plans.....	2,478	2,066
Accumulated other comprehensive loss.....	(8)	--
Treasury stock, at cost:		
Common stock: 71,807,227 and 67,396,876 shares as of November 30, 2007 and 2006, respectively.....	(5,641)	(4,445)
	-----	-----
Total Stockholders' Equity.....	11,793	12,129
	-----	-----
Total Liabilities and Stockholders' Equity.....	\$ 96,077	\$ 91,382
	=====	=====

**See Notes to Condensed Financial Information.**

**CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
THE BEAR STEARNS COMPANIES INC.  
(PARENT COMPANY ONLY)**

**CONDENSED STATEMENTS OF CASH FLOWS**  
(in millions)

Fiscal Years Ended November 30,	2007	2006	2005
	-----	-----	-----
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income.....	\$ 233	\$ 2,054	\$ 1,462
Adjustments to reconcile net income to cash provided by operating activities:			
Non-cash items included in net income:			
Employee stock compensation plans.....	31	1,010	801
Equity in earnings of subsidiaries, net of dividends received.....	(1,292)	(493)	(876)
Other.....	14	10	10
Decreases (increases) in assets:			
Securities purchased under agreements to resell.....	(1,312)	77	99
Other assets.....	(2,397)	1,007	(34)
Increases (decreases) in liabilities:			
Payables to subsidiaries.....	388	1,566	1,276
Other liabilities and accrued expenses.....	2,071	(50)	306
	-----	-----	-----
Cash provided by operating activities.....	(2,264)	5,181	3,044
	-----	-----	-----
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Short-term borrowings, net.....	(10,744)	9,898	4,524
Collateralized financings	122	--	--
Proceeds from issuance of long-term borrowings.....	21,193	16,503	14,112
Issuance of common stock.....	162	289	202
Cash retained resulting from tax deductibility under share-based payment arrangements.....	254	363	426
Redemption of preferred stock.....	(7)	(13)	(76)
Payments for:			
Retirement of long-term borrowings.....	(8,865)	(7,143)	(5,966)
Treasury stock purchases.....	(1,670)	(1,374)	(870)
Cash dividends paid.....	(172)	(155)	(139)
	-----	-----	-----
Cash provided by financing activities.....	273	18,368	12,213
	-----	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Receivables from subsidiaries.....	19,200	(23,691)	(11,313)
Subordinated loans receivable from subsidiaries.....	(2,985)	223	(1,469)
Investments in subsidiaries, net.....	1,170	(228)	(321)
	-----	-----	-----
Cash provided by (used in) investing activities.....	17,385	(23,696)	(13,103)
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents.....	15,394	(147)	2,154
Cash and cash equivalents, beginning of fiscal year.....	2,007	2,154	--
	-----	-----	-----
Cash and cash equivalents, end of fiscal year.....	\$ 17,401	\$ 2,007	\$ 2,154
	=====	=====	=====

**See Notes to Condensed Financial Information.**

**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**THE BEAR STEARNS COMPANIES INC.**  
(PARENT COMPANY ONLY)

**NOTES TO CONDENSED FINANCIAL INFORMATION**

1. General

The condensed financial information of the Company (Parent Company Only) should be read in conjunction with the Consolidated Financial Statements of The Bear Stearns Companies Inc. and subsidiaries and the Notes thereto in The Bear Stearns Companies Inc. 2007 Annual Report to Stockholders (the "Annual Report") incorporated by reference in this Form 10-K.

The condensed unconsolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America which require management to make certain estimates and assumptions, including those regarding fair value measurements, stock-based compensation, certain accrued liabilities and the potential outcome of litigation and tax matters, which may affect the amounts reported in the condensed unconsolidated financial statements and accompanying notes. Actual results could differ materially from these estimates.

Investments in wholly owned or other subsidiaries are accounted for using the equity method.

For information on the following, refer to the indicated Notes to the Consolidated Financial Statements within the Annual Report.

- o Summary of Significant Accounting Policies (Note 1)
- o Fair Value of Financial Instruments (Note 2)
- o Financial Instruments (Note 3)
- o Variable Interest Entities and Mortgage Loan Special Purpose Entities (Note 6)
- o Short-Term Borrowings (Note 8)
- o Long-Term Borrowings (Note 9)
- o Preferred Stock (Note 10-refer to section entitled "Preferred Stock Issued by The Bear Stearns Companies Inc.")
- o Employee Benefit Plan (Note 12)
- o Stock Compensation Plans (Note 13)
- o Commitments and Contingencies (Note 17)

The Company engages in derivatives activities in order to modify the interest rate characteristics of its long and short-term debt. See "Hedging Activity" section of Note 4, "Derivatives and Hedging Activities", to the Consolidated Financial Statements in the Annual Report.

2. Statement of Cash Flows

Income taxes paid, net of refunds (consolidated) totaled approximately \$561 million, \$709 million and \$146 million for the fiscal years ended November 30, 2007, 2006 and 2005, respectively. Cash payments for income taxes, net of refunds, would have been approximately \$815 million, \$1.1 billion and \$572 million for the fiscal years ended November 30, 2007, 2006 and 2005, respectively, if increases in the value of equity instruments issued under share-based payment arrangements had not been deductible in determining taxable income. Cash payments for interest approximated interest expense for each of the periods presented.

**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**THE BEAR STEARNS COMPANIES INC.**  
(PARENT COMPANY ONLY)

**NOTES TO CONDENSED FINANCIAL INFORMATION (CONTINUED)**

3. Transactions with Subsidiaries

In the ordinary course of business the Company generates interest income by providing financing to its subsidiaries.

The Company received from its consolidated subsidiaries dividends of approximately \$1.5 billion, \$1.8 billion and \$787 million for the fiscal years ended November 30, 2007, 2006 and 2005, respectively. In addition, the Company provides its subsidiaries with the use of fixed assets for which the Company charges a fee.

The Company has transactions with its subsidiaries determined on an agreed-upon basis. The Company also guarantees certain unsecured lines of credit and certain other obligations of subsidiaries, including obligations associated with foreign exchange forward contracts and interest rate swap transactions. Additionally, the Company guarantees certain obligations related to Guaranteed Preferred Beneficial Interests in Company Subordinated Debt Securities issued by subsidiaries.

The Company also issues guarantees of counterparty obligations to subsidiaries in connection with certain activities of such subsidiaries.

4. Subsequent Event

Refer to Note 23, "Subsequent Events," in the Notes to Consolidated Financial Statements in Exhibit 99.1 to the Current Report on Form 8-K dated April 11, 2008.

### Exhibit 99.3

#### **JPMORGAN CHASE & CO./THE BEAR STEARNS COMPANIES INC. UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION**

The following unaudited pro forma combined financial information and explanatory notes present how the combined financial statements of JPMorgan Chase and Bear Stearns may have appeared had the companies actually been combined as of the date indicated. The unaudited pro forma combined statement of income for the year ended December 31, 2007 gives effect to the merger as if the merger had been completed on January 1, 2007. The unaudited pro forma combined balance sheet at December 31, 2007 assumes the merger was completed on that date. The unaudited pro forma combined financial information shows the impact of the merger on JPMorgan Chase's and Bear Stearns' combined financial position and results of operations under the purchase method of accounting with JPMorgan Chase treated as the acquirer. Under this method of accounting, JPMorgan Chase will record the assets and liabilities of Bear Stearns at their estimated fair values as of the date the merger is completed.

The unaudited pro forma combined financial information has been derived from and should be read in conjunction with the historical consolidated financial statements and the related notes of both JPMorgan Chase and Bear Stearns.

The unaudited pro forma combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the companies actually been combined at the beginning of the period presented. In addition, as explained in more detail in the accompanying notes to unaudited pro forma combined financial information, the resulting extraordinary gain reflected in the unaudited pro forma combined financial information is subject to adjustment. Bear Stearns is a broker-dealer, and many of the assets and liabilities on its consolidated balance sheet are financial assets carried at fair value, or are short-term in nature. For those that are short-term in nature, the carrying value approximates fair value. For purposes of these unaudited pro forma combined financial statements no valuation adjustments were applied to Bear Stearns' assets and liabilities carried at fair value or those which are short-term in nature, except for adjustments to reflect JPMorgan Chase credit spreads on trading liabilities and long-term debt. The adjustments included in these unaudited pro forma combined financial statements are preliminary and may be revised. The fair value of Bear Stearns' pro forma net assets at November 30, 2007 is estimated to be \$10.3 billion, which exceeds the estimated \$1.4 billion purchase price. This results in negative goodwill. In accordance with U.S. GAAP, nonfinancial assets that are not held for sale, such as Bear Stearns' premises and equipment and other intangibles, were written down against the negative goodwill. Upon consummation of the merger, any negative goodwill remaining after writing down nonfinancial assets will be recognized as an extraordinary gain. For further information, see Note 3 to these unaudited pro forma combined financial statements. After completing a fair value analysis of Bear Stearns' assets and liabilities as of the closing date, the final allocation of negative goodwill to nonfinancial assets and then the extraordinary gain will be determined. This unaudited pro forma financial information represents management's current estimate of the combined financial information based on available financial information of JPMorgan Chase and Bear Stearns as of year end 2007. The final purchase accounting adjustments may be materially different from the unaudited pro forma adjustments presented in this document.

**JPMORGAN CHASE & CO./THE BEAR STEARNS COMPANIES INC.**  
**UNAUDITED PRO FORMA COMBINED STATEMENT OF INCOME**

For the Year Ended December 31, 2007 and November 30, 2007 In millions (except per share data)

	JPMorgan Chase Year ended December 31, 2007	Bear Stearns Year ended November 30, 2007	Reporting reclassifications	Pro forma adjustments	Pro forma combined
Revenue					
Investment banking fees	\$ 6,635	\$ 1,380	\$ (286)/(1)/ (23)/(2)/	\$ --	\$ 7,706
Principal transactions	9,015	1,323	23/(2)/ (130)/(3)/	--	10,231
Lending & deposit-related fees	3,938	--	--	--	3,938
Asset management, administration and commissions	14,356	--	(2,702)/(4)/ 597/(5)/	--	12,251
Asset management and other income	--	623	(623)/(5,6)/	--	--
Commissions	--	1,269	(1,269)/(7)/	--	--
Brokerage commissions	--	--	3,971/(4,7)/	--	3,971
Securities gains (losses)	164	--	--	--	164
Mortgage fees and related income	2,118	--	416/(1,3)/	--	2,534
Credit card income	6,911	--	--	--	6,911
Other income	1,829	--	26/(6)/	--	1,855
Noninterest revenue	44,966	4,595	--	--	49,561
Interest income	71,387	11,556	--	--	82,943
Interest expense	44,981	10,206	--	186/(A)/	55,373
Net interest income	26,406	1,350	--	(186)	27,570
Total net revenue	71,372	5,945	--	(186)	77,131
Provision for credit losses	6,864	--	--	--	6,864
Noninterest expense					
Compensation expense	22,689	3,425	--	--	26,114
Occupancy expense	2,608	264	--	(23)/(B)/	2,849
Technology, communications and equipment expense	3,779	578	(85)/(8)/	(131)/(B)/	4,141
Professional & outside services	5,140	362	(929)/(8,9)/	--	4,573
Floor brokerage, exchange and clearance expense	--	279	1,014/(9)/	--	1,293
Marketing	2,070	179	--	--	2,249
Other expense	3,814	438	221/(10,11)/	(227)/(C)/ 21/(D)/	4,267
Impairment of goodwill and specialist rights	--	227	(227)/(10)/	--	--
Amortization of intangibles	1,394	--	6/(11)/	--	1,400
Merger costs	209	--	--	--	209
Total noninterest expense	41,703	5,752	--	(360)	47,095
Income from continuing operations before income tax expense	22,805	193	--	174	23,172
Income tax expense	7,440	(40)	--	61/(E)/	7,461
Income from continuing operations	\$15,365	\$ 233	\$ --	\$ 113	\$15,711
Per common share information					
Income from continuing operations:					
Basic earnings per share	\$ 4.51	\$ 1.68			\$ 4.58
Diluted earnings per share	4.38	1.52			4.43
Average common shares outstanding	3,404	130		(102)/(F)/	3,432
Average diluted common shares outstanding	3,508	146		(107)/(F)/	3,547

**JPMORGAN CHASE & CO./THE BEAR STEARNS COMPANIES INC.**  
**UNAUDITED PRO FORMA COMBINED BALANCE SHEET**

December 31, 2007 and November 30, 2007

In millions (except per share data)

	JPMorgan Chase December 31, 2007	Bear Stearns November 30, 2007	Reporting reclassifications	Pro forma adjustments	Pro forma combined
	-----	-----	-----	-----	-----
<b>Assets</b>					
Cash and due from banks	\$ 40,144	\$ 21,406	\$ 9,010/(1)/ (200)/(2)/	\$ (1,179)/(G)/ 29,000/(H)/	\$ 98,181
Deposits with banks	11,466	--	--	--	11,466
Cash and securities deposited with clearing organizations or segregated in compliance with federal regulations	--	12,890	(9,010)/(1)/ (3,880)/(3)/	--	--
Federal funds sold and securities purchased under resale agreements	170,897	--	27,878/(4)/	--	198,775
Collateralized agreements: Securities purchased under agreements to resell	--	27,878	(27,878)/(4)/	--	--
Securities borrowed	84,184	82,245	--	--	166,429
Securities received as collateral	--	15,599	--	--	15,599
Trading assets	491,409	--	170,705/(5,6,14)/ (137)/(2)/	(981)/(I)/ (29,000)/(H)/	631,996
Financial instruments owned, at fair value	--	122,518	(122,518)/(5)/	--	--
Financial instruments owned and pledged as collateral, at fair value	--	15,724	(15,724)/(6)/	--	--
Securities	85,450	--	--	--	85,450
Loans	519,374	--	--	--	519,374
Allowance for loan losses	(9,234)	--	--	--	(9,234)
	-----	-----	-----	-----	-----
Loans, net of Allowance for loan losses	510,140	--	--	--	510,140
Accrued interest and accounts receivable	24,823	--	41,900/(7)/ 642/(8)/	--	67,365
Receivables:					
Customers	--	41,115	(41,115)/(7)/	--	--
Brokers, dealers and others	--	11,622	(11,622)/(9)/	--	--
Interest and dividends	--	785	(785)/(7)/	--	--
Brokerage receivables	--	--	11,622/(9)/ 9,564/(10)/	(5,788)/(J)/	15,398
Premises and equipment	9,319	605	--	(605)/(K)/	9,319
Goodwill	45,270	--	82/(11)/	(82)/(L)/	45,270
Other intangible assets:					
Mortgage servicing rights	8,632	--	833/(12)/	--	9,465
Purchased credit card relationships	2,303	--	--	--	2,303
All other intangibles	3,796	--	7/(13)/	(7)/(L)/	3,796
Other assets	74,314	9,422	(6,158)/(3,8,10,11,12,13,15)/ 306/(2)/	24/(M)/ (1,160)/(N)/	76,748
Assets of variable interest entities and mortgage loan special purpose entities	--	33,553	(32,463)/(14)/ (1,090)/(15)/	--	--
	-----	-----	-----	-----	-----
<b>Total assets</b>	<b>\$1,562,147</b>	<b>\$395,362</b>	<b>\$ (31)</b>	<b>\$ (9,778)</b>	<b>\$1,947,700</b>
	=====	=====	=====	=====	=====

**JPMORGAN CHASE & CO./THE BEAR STEARNS COMPANIES INC.**  
**UNAUDITED PRO FORMA COMBINED BALANCE SHEET (Continued)**

December 31, 2007 and November 30, 2007

In millions (except per share data)

	JPMorgan Chase December 31, 2007	Bear Stearns November 30, 2007	Reporting reclassifications	Pro forma adjustments	Pro forma combined
	-----	-----	-----	-----	-----
<b>Liabilities</b>					
Deposits	\$ 740,728	\$ --	\$ --	\$ (1,179)/(G)/	\$ 739,549
Federal funds purchased and securities sold under repurchase agreements	154,398	--	102,373/(16)/ (10,922)/(17)/	--	245,849
Collateralized financings:					
Securities sold under agreements to repurchase	--	102,373	(102,373)/(16)/	--	--
Securities loaned	--	3,935	(3,935)/(18)/	--	--
Other secured borrowings	--	12,361	(12,361)/(19)/	--	--
Securities loaned	--	--	14,857/(17,18)/	--	14,857
Commercial paper	49,596	--	3,901/(20)/	--	53,497
Unsecured short-term borrowings	--	11,643	(3,901)/(20)/ (7,742)/(21)/	--	--
Obligation to return securities received as collateral	--	15,599	--	--	15,599
Other borrowed funds	28,835	--	20,103/(19,21)/	--	48,938
Trading liabilities	157,867	--	43,807/(22)/ (31)/(2)/	307/(O)/ (981)/(I)/	200,969
Financial instruments sold, but not yet purchased, at fair value	--	43,807	(43,807)/(22)/	--	--
Accounts payable, accrued expense and other liabilities	94,476	--	75,995/(23,25,26,27)/	352/(D)/	170,823
Payables:					
Customers	--	83,204	(83,204)/(23)/	--	--
Brokers, dealers and others	--	4,101	(4,101)/(24)/	--	--
Interest and dividends	--	1,301	(1,301)/(23)/	--	--
Brokerage payables	--	--	4,101/(24)/ 14,612/(25)/	(5,788)/(J)/	12,925
Accrued employee compensation and benefits	--	1,651	(1,651)/(26)/	--	--
Other liabilities and accrued expenses	--	4,451	(4,451)/(27)/	--	--
Beneficial interests issued by consolidated variable interest entities	14,016	--	30,605/(28)/	--	44,621
Liabilities of variable interest entities and mortgage loan special purpose entities	--	30,605	(30,605)/(28)/	--	--
Long-term debt	183,862	68,538	(263)/(29)/	399/(O)/ (834)/(A)/	251,702
Junior subordinated deferrable interest debentures held by trusts that issued guaranteed capital debt securities	15,148	--	263/(29)/	--	15,411
<b>Total liabilities</b>	<b>1,438,926</b>	<b>383,569</b>	<b>(31)</b>	<b>(7,724)</b>	<b>1,814,740</b>
<b>Stockholders' equity</b>					
Preferred stock	--	352		(352)/(D)/	--
Common stock	3,658	185		25/(P)/ (185)/(P)/	3,683
Capital surplus	78,597	--		1,348/(P)/	79,945
Paid-in capital	--	4,986		(4,986)/(P)/	--
Employee stock compensation plans	--	2,478		(2,478)/(P)/	--
Retained earnings	54,715	9,441		8,366/(Q)/ (9,441)/(P)/	63,081
Accumulated other comprehensive income (loss)	(917)	(8)		8/(P)/	(917)
Treasury stock, at cost	(12,832)	(5,641)		5,641/(P)/	(12,832)
<b>Total stockholders' equity</b>	<b>123,221</b>	<b>11,793</b>		<b>(2,054)</b>	<b>132,960</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$1,562,147</b>	<b>\$395,362</b>	<b>\$ (31)</b>	<b>\$(9,778)</b>	<b>\$1,947,700</b>
	=====	=====	=====	=====	=====

## NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION

### Note 1--Basis of Pro Forma Presentation

The unaudited pro forma combined financial information relating to the merger of JPMorgan Chase with Bear Stearns is presented as of and for the year ended December 31, 2007 for JPMorgan Chase and as of and for the year ended November 30, 2007 for Bear Stearns.

The reporting reclassifications column represents the change in presentation of the historical consolidated financial statements of Bear Stearns and JPMorgan Chase to conform to the preliminary presentation of such information for the combined entity as discussed in Note 2. For purposes of identifying the reclassification between line items on the financial statements, numerical references are provided to reflect where balances have been reclassified.

JPMorgan Chase and Bear Stearns are in the process of reviewing their accounting and reporting policies and, as a result of this review, it may be necessary to adjust either JPMorgan Chase's or Bear Stearns' financial statements to conform to those accounting policies that are determined by the combined company to be most appropriate. While some reclassifications have been included in the unaudited pro forma combined financial information included in this document, further reclassifications may be necessary upon the completion of this review. Final determination of financial statement presentation will be completed upon consummation of the merger.

Material intercompany transactions have been eliminated from the accompanying unaudited pro forma combined financial information. However the information does not reflect the elimination of hedge accounting results. Management believes this presentation is more reflective of the pro forma results of the combined entity, as derivatives that have qualified for hedge accounting in the periods presented will continue to qualify as hedges until the date the merger is completed; and it is management's intent to replace derivatives currently used for hedging purposes which will become intercompany, with new third-party derivative contracts.

The pro forma adjustments reflect the conversion of 112,998,620 shares (shares issued of 184,805,847, less treasury shares of 71,807,227) of Bear Stearns common stock outstanding at November 30, 2007, into JPMorgan Chase common stock using an exchange ratio of 0.21753 multiplied by the JPMorgan Chase average share price of \$45.26. The average share price was computed using the closing prices of the four trading days during the period March 19, 2008 through March 25, 2008. Also included in the purchase price of the merger is the estimated fair value of the Bear Stearns employee stock awards that are expected to be vested for accounting purposes following consummation of the merger and that will be converted into JPMorgan Chase employee stock awards. The estimated fair value of these awards is \$261 million. The total estimated purchase price of the merger for purposes of this pro forma financial information is \$1.4 billion.

The merger will be accounted for using the purchase method of accounting, which requires that the assets and liabilities of Bear Stearns be recorded at their estimated fair value as of the date of acquisition.

The unaudited pro forma combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the companies actually been combined at the beginning of the period presented, nor is it indicative of the results of operations in future periods or the future financial position of the combined company. In addition, as explained in more detail in the accompanying notes to unaudited pro forma combined financial information, the resulting extraordinary gain reflected in the unaudited pro forma combined financial information is subject to adjustment. Bear Stearns is a broker-dealer, and many of the assets and liabilities on its consolidated balance sheet are financial assets carried at fair value, or are short-term in nature. For those that are short term in nature, the carrying value approximates fair value. For purposes of these unaudited pro forma combined financial statements no valuation adjustments were applied to Bear Stearns' assets and liabilities carried at fair value or those which are short-term in nature, except for

adjustments to reflect JPMorgan Chase credit spreads on trading liabilities and long-term debt. The adjustments included in these unaudited pro forma combined financial statements are preliminary and may be revised. The fair value of Bear Stearns' pro forma net assets at November 30, 2007 is estimated to be \$10.3 billion, which exceeds the estimated \$1.4 billion purchase price. This results in negative goodwill. In accordance with U.S. GAAP, nonfinancial assets that are not held for sale, such as Bear Stearns' premises and equipment, and other intangibles, were written down against the negative goodwill. Upon consummation of the merger, any negative goodwill remaining after writing down nonfinancial assets will be recognized as an extraordinary gain. For further information, see Note 3 to these unaudited pro forma combined financial statements. After completing a fair value analysis of Bear Stearns' assets and liabilities as of the closing date, the final allocation of negative goodwill to nonfinancial assets and the amount of the extraordinary gain will be determined. The final purchase accounting adjustments may be materially different from the unaudited pro forma adjustments presented in this document.

## **Note 2--Reporting Reclassifications**

### **Income Statement**

- 1 - Adjustment to reclassify Bear Stearns' mortgage servicing fees and advances from investment banking fees into mortgage fees and related income to conform to JPMorgan Chase's classification.
- 2 - Adjustment to reclassify Bear Stearns' merchant banking revenue from investment banking fees into principal transactions revenue to conform to JPMorgan Chase's classification.
- 3 - Adjustment to reclassify Bear Stearns' changes in the fair value of mortgage servicing rights from principal transactions revenue into mortgage fees and related income to conform to JPMorgan Chase's classification.
- 4 - Adjustment to reclassify JPMorgan Chase's brokerage commissions from asset management, administration and commissions into brokerage commissions to conform to the combined JPMorgan Chase classification.
- 5 - Adjustment to reclassify Bear Stearns' asset management income from asset management and other income into asset management, administration and commissions to conform to JPMorgan Chase's classification.
- 6 - Adjustment to reclassify Bear Stearns' other income from asset management and other income into other income to conform to JPMorgan Chase's classification.
- 7 - Adjustment to reclassify Bear Stearns' commissions income into brokerage commissions income to conform to the combined JPMorgan Chase classification.
- 8 - Adjustment to reclassify Bear Stearns' information technology consultant expense from technology, communications and equipment expense into professional & outside services to conform to JPMorgan Chase's classification.
- 9 - Adjustment to reclassify JPMorgan Chase's brokerage commission expense from professional & outside services into floor brokerage, exchange and clearance expense to conform to the combined JPMorgan Chase classification.
- 10 - Adjustment to reclassify Bear Stearns' impairment of goodwill and specialist rights into other expense to conform to JPMorgan Chase's classification.
- 11 - Adjustment to reclassify Bear Stearns' amortization of intangibles from other expense into amortization of intangibles to conform to JPMorgan Chase's classification.

### **Balance Sheet**

- 1 - Adjustment to reclassify Bear Stearns' cash segregated in compliance with federal regulations from cash and securities deposited with clearing organizations or segregated in compliance with federal regulations into cash and due from banks to conform to JPMorgan Chase's classification.

- 2 - Adjustment for the timing difference between Bear Stearns' intercompany balances as of November 30, 2007 and JPMorgan Chase intercompany balances as of December 31, 2007.
- 3 - Adjustment to reclassify Bear Stearns' cash and securities deposited with clearing organizations from cash and securities deposited with clearing organizations or segregated in compliance with federal regulations into other assets to conform to JPMorgan Chase's classification.
- 4 - Adjustment to reclassify Bear Stearns' collateralized agreements: securities purchased under agreements to resell into federal funds sold and securities purchased under resale agreements to conform to JPMorgan Chase's classification.
- 5 - Adjustment to reclassify Bear Stearns' financial instruments owned, at fair value into trading assets to conform to JPMorgan Chase's classification.
- 6 - Adjustment to reclassify Bear Stearns' financial instruments owned and pledged as collateral, at fair value into trading assets to conform to JPMorgan Chase's classification.
- 7 - Adjustment to reclassify Bear Stearns' receivables: customers, and interest and dividends into accrued interest and accounts receivable to conform to JPMorgan Chase's classification.
- 8 - Adjustment to reclassify Bear Stearns' accounts receivable and fees receivable from other assets into accrued interest and accounts receivable to conform to JPMorgan Chase's classification.
- 9 - Adjustment to reclassify Bear Stearns' receivables: brokers, dealers and others into brokerage receivables to conform to the combined JPMorgan Chase classification.
- 10 - Adjustment to reclassify JPMorgan Chase's brokerage-related receivables from other assets into brokerage receivables to conform to the combined JPMorgan Chase classification.
- 11 - Adjustment to reclassify Bear Stearns' goodwill from other assets into goodwill to conform to JPMorgan Chase's classification.
- 12 - Adjustment to reclassify Bear Stearns' mortgage servicing rights from other assets into mortgage servicing rights to conform to JPMorgan Chase's classification.
- 13 - Adjustment to reclassify Bear Stearns' intangibles from other assets into all other intangibles to conform to JPMorgan Chase's classification.
- 14 - Adjustment to reclassify Bear Stearns' assets of variable interest entities and mortgage loan special purpose entities: mortgage securitization; and collateralized debt and loan obligations into trading assets to conform to JPMorgan Chase's classification.
- 15 - Adjustment to reclassify Bear Stearns' assets of variable interest entities and mortgage loan special purpose entities: employee funds; and energy investments into other assets to conform to JPMorgan Chase's classification.
- 16 - Adjustment to reclassify Bear Stearns' collateralized financings: securities sold under agreements to repurchase into federal funds purchased and securities sold under repurchase agreements to conform to JPMorgan Chase's classification.
- 17 - Adjustment to reclassify JPMorgan Chase's securities loaned from federal funds purchased and securities sold under repurchase agreements into securities loaned to conform to the combined JPMorgan Chase classification.
- 18 - Adjustment to reclassify Bear Stearns' collateralized financings: securities loaned into securities loaned to conform to the combined JPMorgan Chase classification.
- 19 - Adjustment to reclassify Bear Stearns' collateralized financings: other secured borrowings into other borrowed funds to conform to JPMorgan Chase's classification.
- 20 - Adjustment to reclassify Bear Stearns' unsecured borrowings: commercial paper from unsecured short-term borrowings into commercial paper to conform to JPMorgan Chase's classification.
- 21 - Adjustment to reclassify Bear Stearns' unsecured borrowings: bank loans; medium term notes; and other unsecured borrowings from unsecured short-term borrowings into other borrowed funds to conform to JPMorgan Chase's classification.

22 - Adjustment to reclassify Bear Stearns' financial instruments sold, but not yet purchased, at fair value into trading liabilities to conform to JPMorgan Chase's classification.

23 - Adjustment to reclassify Bear Stearns' payables: customers, and interest and dividends into accounts payable, accrued expense and other liabilities to conform to JPMorgan Chase's classification.

24 - Adjustment to reclassify Bear Stearns' payables: brokers, dealers and others into brokerage payables to conform to the combined JPMorgan Chase classification.

25 - Adjustment to reclassify JPMorgan Chase's brokerage-related payables from accounts payable, accrued expense and other liabilities into brokerage payables to conform to the combined JPMorgan Chase classification.

26 - Adjustment to reclassify Bear Stearns' accrued employee compensation and benefits into accounts payable, accrued expense and other liabilities to conform to JPMorgan Chase's classification.

27 - Adjustment to reclassify Bear Stearns' other liabilities and accrued expenses into accounts payable, accrued expense and other liabilities to conform to JPMorgan Chase's classification.

28 - Adjustment to reclassify Bear Stearns' liabilities of variable interest entities and mortgage loan special purpose entities into beneficial interests issued by consolidated variable interest entities to conform to JPMorgan Chase's classification.

29 - Adjustment to reclassify Bear Stearns' junior subordinated deferrable interest debentures from long-term debt into junior subordinated deferrable interest debentures held by trusts that issued guaranteed capital debt securities to conform to JPMorgan Chase's classification.

### Note 3--Unaudited Pro Forma Adjustments

The unaudited pro forma combined financial information reflects (1) the issuance of 24,581,000 shares of JPMorgan Chase common stock with an aggregate value of \$1.1 billion and (2) the conversion of approximately 27,213,792 of Bear Stearns employee stock awards, other than stock options, expected to be vested for accounting purposes into JPMorgan Chase employee stock awards following the merger consummation date with an estimated fair value of \$261 million at November 30, 2007. Bear Stearns vested employee stock options had no impact on the purchase price, as the exercise price of these options significantly exceeds the closing price of the Bear Stearns common stock on March 28, 2008, and since completion of the merger will not constitute a change in control under the provisions of the stock option plan.

In connection with the amendment to the merger agreement, JPMorgan Chase entered into a share exchange agreement under which JPMorgan Chase will acquire 95 million newly issued shares of the Bear Stearns common stock, or 39.5% of the outstanding common stock after giving effect to the issuance, at the same price as provided in the merger agreement.

(in thousands)	Bear Stearns		
-----	-----	-----	-----
	Issued	Treasury	Net Outstanding
	-----	-----	-----
Shares issued and outstanding prior to the merger	184,806	(71,807)	112,999
Shares exchanged per the Share Exchange Agreement/(1)/	95,000	--	95,000
Shares issued after the share exchange	279,806	(71,807)	207,999
Retirement of shares issued to JPMorgan Chase in connection with the share exchange	(95,000)		(95,000)
Treasury shares cancelled in connection with the merger	(71,807)	71,807	--
Shares converted into JPMorgan Chase shares based on the exchange ratio of 0.21753/(2)/	112,999	--	112,999
-----	-----	-----	-----

(1)Represents JPMorgan Chase's acquisition of a 39.5% interest by the exchange of 95 million Bear Stearns common shares for approximately 21 million JPMorgan Chase common shares under the Share Exchange Agreement.

(2)Represents JPMorgan Chase's acquisition of 100% of Bear Stearns' shares by the conversion of all outstanding shares into shares of JPMorgan Chase under the merger agreement.

(in millions, except per share amounts)	December 31, 2007
-----	-----
Purchase price	
Bear Stearns common stock exchanged as of November 30, 2007	

(in thousands)	112,999	
Exchange ratio	0.21753	
	-----	
JPMorgan Chase common stock to be issued (in thousands)	24,581	
Average purchase price per JPMorgan Chase common share/(1)/	\$ 45.26	
	-----	
		\$1,112
Fair value of employee stock awards		261
		-----
Total purchase price		1,373
Net assets to be acquired		
Bear Stearns common stockholders' equity	\$ 11,441	
Bear Stearns goodwill and other intangible assets	(89)	
Adjustments to reflect assets to be acquired at fair value		

Other assets	(1,136)	
Amounts to reflect liabilities assumed at fair value:		
Trading liabilities	(307)	
Long-term debt	435	
	-----	
		10,344
Negative goodwill resulting from the merger		(8,971)
Negative goodwill allocated to nonfinancial assets/(2)/		605
		-----
		\$(8,366)/(3)/
		=====
-----		

(1)The value of JPMorgan Chase common stock was determined by averaging the closing prices of JPMorgan Chase common stock for four trading days during the period March 19, 2008 through March 25, 2008.

(2)Reflects the allocation of excess fair value of net assets acquired over the purchase price which is first used to reduce nonfinancial assets as required by SFAS 141.

(3)JPMorgan Chase and Bear Stearns entered into an agreement to merge on March 16, 2008 and amended the agreement on March 24, 2008. Pursuant to the amended merger agreement each share of Bear Stearns common stock outstanding immediately prior to the merger will be exchanged for 0.21753 shares of JPMorgan Chase common stock. The consummation of the merger is subject to satisfaction of certain closing conditions including the approval of the merger agreement by the majority of Bear Stearns' stockholders.

The purchase price allocation presented in the table above reflects valuations as of November 30, 2007 (Bear Stearns' fiscal year-end). Such allocation does not reflect the effect on inventory valuations of market disruptions and the liquidity crisis encountered by Bear Stearns subsequent to February 29, 2008, merger integration costs and restructuring actions that may be necessary as a result of the merger, or costs likely to be incurred by Bear Stearns to delever its balance sheet prior to the closing of the merger. JPMorgan Chase expects that these items will significantly reduce the negative goodwill to be recognized at the merger date and the combined stockholders' equity of the two firms. JPMorgan Chase currently estimates the range of adjustments not reflected in the purchase price allocation presented above to be approximately \$3 billion to \$5 billion after-tax. The amounts realized at the merger date could differ materially from this estimate depending on market conditions.

The pro forma adjustments included in the unaudited pro forma combined financial information for JPMorgan Chase and Bear Stearns as of and for the year ended December 31, 2007, and November 30, 2007, respectively, are as follows:

- (A) Adjustment to decrease the fair-value of Bear Stearns' long-term debt. The adjustment will be recognized over the weighted average remaining life of the long-term debt instruments of 4.49 years. The impact of the adjustment was an increase in pro forma pretax interest expense of \$186 million for 2007.
- (B) Adjustment to reduce occupancy expense and technology, communications and equipment expense for depreciation related to nonfinancial assets written down by the allocation of negative goodwill.
- (C) Adjustment to reverse Bear Stearns' impairment charge related to goodwill and specialist rights.
- (D) Assumes that Bear Stearns preferred stock will become preferred stock of a subsidiary of the combined Firm, and shown in other liabilities as minority interest. The related dividends on the preferred stock is recorded in other expense.
- (E) Adjustment of \$61 million to record the tax effect of the pro forma combined adjustments using a federal tax rate of 35%.
- (F) Average shares were calculated using the historical weighted average shares outstanding of JPMorgan Chase and Bear Stearns for the year ended December 31, 2007 and November 30, 2007, respectively, adjusted using the exchange ratio. Earnings per share data have been computed based on the combined historical income of JPMorgan Chase and Bear Stearns, and the impact of purchase accounting adjustments.
- (G) Adjustment to eliminate intercompany deposits.
- (H) Concurrent with the closing of the merger, the New York Fed will take, through a limited liability company formed for this purpose, control of a portfolio of \$30 billion in assets of Bear Stearns, based on the value of the portfolio as of March 14, 2008. The assets will be funded by a \$29 billion, 10-year term loan from the New York Fed, and a \$1 billion, 10-year subordinated note from JPMorgan Chase. The JPMorgan Chase note is subordinated to the New York Fed loan and will bear the first \$1 billion of losses associated with the assets. Any funds remaining after payment of the New York Fed loan, the JPMorgan Chase note and other expenses of the Limited Liability Company, will be paid to the New York Fed.
- (I) Adjustment to eliminate intercompany derivatives used for trading purposes.
- (J) Adjustment to net JPMorgan Chase trade date payables with net Bear Stearns trade date receivables.
- (K) Adjustment to write off Bear Stearns nonfinancial assets in accordance with SFAS 141-"Business Combinations" as a result of allocating negative goodwill.
- (L) Adjustment to write off historical Bear Stearns goodwill and intangible assets.
- (M) Adjustment to fair value Bear Stearns stock exchange memberships and seats.
- (N) Adjustment to other assets represents a reduced net deferred tax asset of \$304 million resulting from the pro forma adjustments. Deferred taxes were recorded using a federal tax rate of 35%.
- (O) Adjustment to reflect the difference in the observable credit spread related to JPMorgan Chase and Bear Stearns. The observable credit spread is an indicator of the respective firm's credit quality. This debit valuation adjustment ("DVA") modification reflects the enhancement in credit quality resulting from applying the JPMorgan Chase's credit spread to the Bear Stearns liabilities.
- (P) Adjustment to eliminate Bear Stearns' historical stockholders' equity. The adjustment also reflects JPMorgan Chase common stock to be issued to Bear Stearns stockholders and the exchange of Bear Stearns vested stock options, vested restricted stock units and Cap units for corresponding JPMorgan Chase awards.
- (Q) Adjustment to record the extraordinary gain resulting from the merger. The extraordinary gain does not reflect the effect on inventory valuations of market disruptions and the liquidity crisis encountered by Bear Stearns subsequent to February 29, 2008, merger integration costs and restructuring actions that may be necessary as a result of the merger, or costs likely to be incurred by Bear Stearns to delever its balance sheet prior to the closing of the merger. JPMorgan Chase expects that these items will significantly reduce the negative goodwill to be recognized at the merger date and the combined stockholders' equity of the two firms. JPMorgan Chase currently estimates the range of adjustments not reflected in the purchase price allocation presented above to be approximately \$3 billion to \$5 billion after-tax. The amounts realized at the merger date could differ materially from this estimate depending on market conditions.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Stockholders of The Bear Stearns Companies Inc.**

We have reviewed the accompanying condensed consolidated statement of financial condition of The Bear Stearns Companies Inc. and subsidiaries (the "Company") as of February 29, 2008, and the related condensed consolidated statements of income, comprehensive income and cash flows for the three-month periods ended February 29, 2008 and February 28, 2007. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

The accompanying condensed consolidated interim financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Notes 1 and 17 to the condensed consolidated interim financial statements and Note 23 to the annual consolidated financial statements for the year ended November 30, 2007 (included as Exhibit 99.1 in this Current Report on Form 8-K), certain conditions raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Notes 1, 17 and 23 to the respective consolidated financial statements.

As discussed in Note 1 to the condensed consolidated interim financial statements, effective December 1, 2007, the Company adopted the Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109."

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of the Company as of November 30, 2007, and the related consolidated statements of income, comprehensive income, cash flows and changes in stockholders' equity for the year then ended (not presented herein); and in our report dated January 28, 2008 (April 11, 2008 as to Note 23), we expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph concerning matters that raise substantial doubt about the Company's ability to continue as a going concern. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial condition as of November 30, 2007 is fairly stated, in all material respects, in relation to the consolidated statement of financial condition from which it has been derived.

*/s/ Deloitte & Touche LLP*

*New York, New York  
April 14, 2008*

**THE BEAR STEARNS COMPANIES INC.**

Condensed Consolidated Statements of  
Income

	(Unaudited) Three Months Ended	
(in millions, except share and per share data)	February 29, 2008	February 28, 2007
<b>REVENUES</b>		
Commissions	\$ 330	\$ 281
Principal transactions	515	1,342
Investment banking	230	350
Interest and dividends	2,198	2,657
Asset management and other income	154	168
	-----	
Total revenues	3,427	4,798
Interest expense	1,948	2,316
	-----	
Revenues, net of interest expense	1,479	2,482
	-----	
<b>NON-INTEREST EXPENSES</b>		
Employee compensation and benefits	754	1,204
Floor brokerage, exchange and clearance fees	79	56
Communications and technology	154	128
Occupancy	73	57
Advertising and market development	40	37
Professional fees	100	72
Other expenses	126	93
	-----	
Total non-interest expenses	1,326	1,647
	-----	
Income before provision for income taxes	153	835
Provision for income taxes	38	281
	-----	
Net income	\$ 115	\$ 554
Preferred stock dividends	5	6
	-----	
Net income applicable to common shares	\$ 110	\$ 548
	=====	
Basic earnings per share	\$ 0.89	\$ 4.23
Diluted earnings per share	\$ 0.86	\$ 3.82
	=====	
<b>Weighted average common shares outstanding:</b>		
Basic	129,128,281	133,094,747
Diluted	138,539,248	149,722,654
	=====	
Cash dividends declared per common share	\$ 0.32	\$ 0.32
	=====	

**See Notes to Condensed Consolidated Financial Statements.**

**THE BEAR STEARNS COMPANIES INC.**

**Condensed Consolidated Statements of  
Financial Condition**

	(Unaudited)	
	February 29, 2008	November 30, 2007
(in millions, except share data)		
<b>ASSETS</b>		
Cash and cash equivalents	\$ 20,786	\$ 21,406
Cash and securities deposited with clearing organizations or segregated in compliance with federal regulations	14,910	12,890
Securities received as collateral	15,371	15,599
Collateralized agreements:		
Securities purchased under agreements to resell	26,888	27,878
Securities borrowed	87,143	82,245
Receivables:		
Customers	41,990	41,115
Brokers, dealers and others	10,854	11,622
Interest and dividends	488	785
Financial instruments owned, at fair value	118,201	122,518
Financial instruments owned and pledged as collateral, at fair value	22,903	15,724
Total financial instruments owned, at fair value	141,104	138,242
Assets of variable interest entities and mortgage loan special purpose entities	29,991	33,553
Property, equipment and leasehold improvements, net of accumulated depreciation and amortization of \$1,196 and \$1,149 as of February 29, 2008 and November 30, 2007, respectively	608	605
Other assets	8,862	9,422
Total Assets	\$ 398,995	\$ 395,362
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Unsecured short-term borrowings (includes \$434 and \$339 at fair value as of February 29, 2008 and November 30, 2007, respectively)	\$ 8,538	\$ 11,643
Obligation to return securities received as collateral	15,371	15,599
Collateralized financings:		
Securities sold under agreements to repurchase	98,272	102,373
Securities loaned	4,874	3,935
Other secured borrowings	7,778	12,361
Payables:		
Customers	91,632	83,204
Brokers, dealers and others	5,642	4,101
Interest and dividends	853	1,301
Financial instruments sold, but not yet purchased, at fair value	51,544	43,807
Liabilities of variable interest entities and mortgage loan special purpose entities	26,739	30,605
Accrued employee compensation and benefits	360	1,651
Other liabilities and accrued expenses	3,743	4,451
Long-term borrowings (includes \$9,018 and \$8,500 at fair value as of February 29, 2008 and November 30, 2007, respectively)	71,753	68,538
Total Liabilities	\$ 387,099	\$ 383,569
Commitments and contingencies (Note 12)		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock	352	352
Common stock, \$1.00 par value; 500,000,000 shares authorized and 184,805,847 shares issued as of both February 29, 2008 and November 30, 2007	185	185
Paid-in capital	5,619	4,986
Retained earnings	9,419	9,441
Employee stock compensation plans	2,164	2,478
Accumulated other comprehensive income (loss)	25	(8)
Shares held in RSU trust	(2,955)	--
Treasury stock, at cost:		
Common stock: 39,135,671 and 71,807,227 shares as of February 29, 2008 and November 30, 2007, respectively	(2,913)	(5,641)
Total Stockholders' Equity	11,896	11,793
Total Liabilities and Stockholders' Equity	\$ 398,995	\$ 395,362

**See Notes to Condensed Consolidated Financial Statements.**



**THE BEAR STEARNS COMPANIES INC.**

Condensed Consolidated Statements of  
Cash Flows

(in millions)	(Unaudited) Three Months Ended	
	February 29, 2008	February 28, 2007
<hr/>		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 115	\$ 554
Adjustments to reconcile net income to cash used in operating activities:		
Non-cash items included in net income:		
Depreciation and amortization	53	42
Employee stock compensation plans	89	13
Changes in operating assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated in compliance with federal regulations	(2,020)	(322)
Securities borrowed, securities loaned, net	(3,959)	(2,795)
Receivables from customers	(875)	(3,048)
Receivables from brokers, dealers and others	768	(1,188)
Financial instruments owned, at fair value	(830)	(22,958)
Other assets	908	(1,791)
Securities sold under agreements to repurchase, securities purchased under agreements to resell, net	(3,111)	20,409
Payables to customers	8,428	4,904
Payables to brokers, dealers and others	1,541	(305)
Financial instruments sold, but not yet purchased, at fair value	7,803	(54)
Accrued employee compensation and benefits	(1,291)	(1,144)
Other liabilities and accrued expenses	(1,251)	1,525
	<hr/>	<hr/>
Cash provided by (used in) operating activities	6,368	(6,158)
	<hr/>	<hr/>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of property, equipment and leasehold improvements, net	(51)	(67)
	<hr/>	<hr/>
Cash used in investing activities	(51)	(67)
	<hr/>	<hr/>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments for/proceeds from unsecured short-term borrowings, net	(3,105)	4,924
Payments for other secured borrowings, net	(4,583)	(1,757)
Proceeds from issuance of long-term borrowings	4,396	8,082
Payments for retirement/repurchase of long-term borrowings	(3,536)	(3,554)
Payments for/proceeds from issuances of derivatives with a financing element, net	(66)	76
Issuance of common stock	25	62
Cash retained resulting from tax deductibility under share-based payment arrangements	45	205
Treasury stock purchases - common stock	(70)	(473)
Cash dividends paid	(43)	(44)
	<hr/>	<hr/>
Cash (used in) provided by financing activities	(6,937)	7,521
	<hr/>	<hr/>
Net (decrease) increase in cash and cash equivalents	(620)	1,296
Cash and cash equivalents, beginning of year	21,406	4,595
	<hr/>	<hr/>
Cash and cash equivalents, end of period	\$ 20,786	\$ 5,891
	<hr/>	<hr/>

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:**

Cash payments for interest were \$2.32 billion and \$2.51 billion during the three months ended February 29, 2008 and February 28, 2007, respectively. Cash payments for income taxes, net of an approximate \$325 million refund of November 30, 2007 estimated Federal taxes, was (\$294.0) million for the three months ended February 29, 2008 and cash payments for income taxes, net of refunds, was \$108.8 million for the three months ended February 28, 2007. Cash payments for income taxes, net of an approximate \$325 million refund of November 30, 2007 estimated Federal taxes, would have been (\$249.0) million for the three months ended February 29, 2008 if increases in the value of equity instruments issued under share-based payment arrangements had not been deductible in determining taxable income. Cash payments for income taxes, net of refunds, would have been \$313.9 million for the three months ended February 28, 2007 if increases in the value of equity instruments issued under share-based payment arrangements had not been deductible in determining taxable income.

**See Notes to Condensed Consolidated Financial Statements.**

**THE BEAR STEARNS COMPANIES INC.**

Condensed Consolidated Statements of  
Comprehensive Income

(in millions)	(Unaudited) Three months ended	
	February 29, 2008	February 28, 2007
Net Income	\$ 115	\$ 554
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustment	(2)	--
Net gains on cash flow hedges	35	--
Comprehensive income	\$ 148	\$ 554

See Notes to Condensed Consolidated Financial Statements.

# THE BEAR STEARNS COMPANIES INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Description of Business

The Bear Stearns Companies Inc. (the "Company") is a holding company that, through its broker-dealer and international bank subsidiaries, principally Bear, Stearns & Co. Inc. ("Bear Stearns"), Bear, Stearns Securities Corp. ("BSSC"), Bear, Stearns International Limited ("BSIL") and Bear Stearns Bank plc ("BSB"), is primarily engaged in business as a securities broker-dealer operating in three principal segments: Capital Markets, Global Clearing Services and Wealth Management. Capital Markets is comprised of the institutional equities, fixed income and investment banking areas. Global Clearing Services provides clearance-related services for prime brokerage clients and clearance on a fully disclosed basis for introducing broker-dealers. Wealth Management is comprised of the private client services ("PCS") and asset management areas. See Note 15, "Segment Data," in the Notes to Condensed Consolidated Financial Statements for a complete description of the Company's principal segments. The Company also conducts significant activities through other wholly owned subsidiaries, including: Bear Stearns Global Lending Limited; Bear Stearns Bank & Trust Company (formerly known as Custodial Trust Company); Bear Stearns Financial Products Inc. ("BSFP"); Bear Stearns Capital Markets Inc.; Bear Stearns Credit Products Inc.; Bear Stearns Forex Inc. ("BS Forex"); EMC Mortgage Corporation; Bear Stearns Commercial Mortgage, Inc.; Bear Stearns Investment Products Inc.; and Bear Energy L.P.

#### Subsequent Events

The Company experienced a significant liquidity crisis during the end of the week of March 10, 2008 that seriously jeopardized its financial viability and which raises substantial doubt about its ability to continue as a going concern. As a result, on March 16, 2008, the Company and JPMorgan Chase & Co. ("JPMorgan Chase") entered into an agreement and plan of merger, and on March 24, 2008, entered into an amendment to the agreement and plan of merger (as amended the "Merger Agreement"). Pursuant to the Merger Agreement each share of the Company's common stock outstanding immediately prior to the merger will be exchanged for 0.21753 shares of JPMorgan Chase common stock. A summary of the Merger Agreement, related transaction documents and the accounting implications are described in more detail in the Transaction Documents and Accounting Implications sections of Note 17, "Subsequent Events," of Notes to Condensed Consolidated Financial Statements.

In connection with the entry into the amendment to the Merger Agreement, the Company and JPMorgan Chase entered into a share exchange agreement under which JPMorgan Chase will purchase 95 million newly issued shares of the Company's common stock, or 39.5% of the outstanding common stock of the Company after giving effect to the issuance, in exchange for the issuance of 20,665,350 shares of JPMorgan Chase common stock to the Company and the entry by JPMorgan Chase into an amended and restated guaranty agreement and the guaranty agreement with the Federal Reserve Bank of New York ("New York Fed"). The share exchange was completed on April 8, 2008.

Concurrent with the closing of the merger, the New York Fed will take, through a limited liability company formed for this purpose, control of a portfolio of \$30 billion in assets of the Company based on the value of the portfolio as of March 14, 2008. The assets will be funded by a \$29 billion, 10-year term note from the New York Fed, and a \$1 billion, 10-year subordinated note from JPMorgan Chase. The JPMorgan Chase note is subordinated to the New York Fed loan and will bear the first \$1 billion of any losses associated with the assets. Any funds remaining after payment of the New York Fed loan, the JPMorgan Chase note and other expenses of the limited liability company, will be paid to the New York Fed.

Since the liquidity crisis and the announcement of the merger, the Company has experienced substantial deterioration of its earnings capacity. The closing of the merger is expected to occur by June 30, 2008. The Company believes that the termination of the JPMorgan Chase guaranties prior to consummation of the merger or the parties' failure to consummate the merger could seriously jeopardize the Company's financial viability. In addition, absent the Guaranty, the Company could face the increased risk of rapid loss of customers and counterparties. The lack of liquidity and the loss of customers and counterparties would materially adversely affect the Company's financial stability and its viability as a going concern. Accordingly, the Company could be forced to file for bankruptcy protection and need to liquidate. The accompanying Condensed Consolidated Financial

**THE BEAR STEARNS COMPANIES INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

Statements do not reflect any adjustments that might result if the Company were unable to continue as a going concern.

**Basis of Presentation**

The Condensed Consolidated Financial Statements include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest. All material intercompany transactions and balances have been eliminated in consolidation.

The Company determines whether it has a controlling financial interest in an entity by evaluating whether an entity is a voting interest entity, a variable interest entity ("VIE") or a qualifying special purpose entity ("QSPE") under generally accepted accounting principles.

Voting interest entities are consolidated in accordance with Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements," as amended. ARB No. 51 states that the usual condition for a controlling financial interest in an entity is ownership of a majority voting interest. Accordingly, the Company consolidates voting interest entities in which it has a majority voting interest. VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE occurs when an entity has a variable interest that will absorb a majority of the VIEs expected losses, receive a majority of the VIEs residual returns, or both. The entity with the controlling financial interest, known as the primary beneficiary, consolidates the VIE. In accordance with Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 46 (R), "Consolidation of Variable Interest Entities (revised December 2003)--an interpretation of Accounting Research Bulletin ("ARB") No. 51" ("FIN No. 46 (R)"), the Company consolidates any variable interest entities for which it is the primary beneficiary. The assets and related liabilities of such variable interest entities have been shown in the Condensed Consolidated Statements of Financial Condition in the captions "Assets of variable interest entities and mortgage loan special purpose entities" and "Liabilities of variable interest entities and mortgage loan special purpose entities." See Note 5, "Variable Interest Entities and Mortgage Loan Special Purpose Entities," in the Notes to Condensed Consolidated Financial Statements. QSPEs are passive entities that are commonly used in securitization transactions. Statement of Financial Accounting Standards ("SFAS") No. 140, "Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," sets forth the criteria an entity must satisfy to be a QSPE. In accordance with SFAS No. 140, the Company does not consolidate QSPEs.

When the Company does not have a controlling interest in an entity, but exerts significant influence over the entity's operating and financial decisions (generally defined as owning a voting or economic interest of 20% to 50%), the Company applies the equity method of accounting.

The Company follows Emerging Issues Task Force ("EITF") Issue No. 04-5 "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights." The EITF consensus requires a general partner in a limited partnership to consolidate the limited partnership unless the presumption of control is overcome. The general partner may overcome this presumption of control and not consolidate the entity if the limited partners have: (a) the substantive ability to dissolve or liquidate the limited partnership or otherwise remove the general partner without having to show cause; or (b) substantive participating rights in managing the partnership.

The Condensed Consolidated Statement of Financial Condition as of February 29, 2008, the Condensed Consolidated Statements of Income, Cash Flows, and Comprehensive Income for the three months ended February 29, 2008 and February 28, 2007 are unaudited. The Condensed Consolidated Statement of Financial Condition at November 30, 2007 and related information were derived from the audited consolidated financial statements included in the Company's Current Report on Form 8-K, which was filed with the Securities and Exchange Commission ("SEC") on April 11, 2008 (the "Form 8-K").

**THE BEAR STEARNS COMPANIES INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

The Condensed Consolidated Financial Statements are prepared in accordance with the rules and regulations of the SEC with respect to the Quarterly Report on Form 10-Q and reflect all adjustments which, in the opinion of management, are normal and recurring, and which are necessary for a fair statement of the results for the interim periods presented. In accordance with such rules and regulations, certain disclosures that are normally included in annual financial statements have been omitted. These Condensed Consolidated Financial Statements should be read together with the Form 8-K.

The Condensed Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. These principles require management to make certain estimates and assumptions, including those regarding fair value measurements, stock-based compensation, certain accrued liabilities, the potential outcome of litigation and tax matters, and the realizability of deferred tax assets, which may affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying notes. Actual results could differ materially from these estimates. The nature of the Company's business is such that the results of any interim period may not be indicative of the results to be expected for an entire fiscal year.

**Revenue Recognition Policies**

**Principal Transactions**

Financial instruments owned and financial instruments sold, but not yet purchased, including contractual commitments arising pursuant to futures, forward and option contracts, interest rate swaps and other derivative contracts, are recorded at fair value with the resulting net unrealized gains and losses reflected in "Principal transactions" revenues in the Condensed Consolidated Statements of Income.

**Investment Banking and Advisory Services**

Underwriting revenues and fees for mergers and acquisitions advisory services are accrued when services for the transactions are substantially completed. Transaction expenses are deferred until the related revenue is recognized. Investment banking and advisory services revenues are presented net of transaction-related expenses.

**Mortgage Servicing Fees and Advances**

Contractual servicing fees, late fees and other ancillary servicing fees earned for servicing mortgage loans are reflected in "Investment banking" revenues in the Condensed Consolidated Statements of Income. Contractual servicing fees are recognized when earned based on the terms of the servicing agreement. All other fees are recognized when received. In the normal course of its business, the Company makes principal, interest and other servicing advances to external investors on mortgage loans serviced for these investors. Such advances are generally recoverable from the mortgagors, related securitization trusts or from the proceeds received from the sales of the underlying properties. A charge to earnings is recognized to the extent that servicing advances are estimated to be uncollectible under the provisions of the servicing contracts.

**Commissions**

Commission revenues primarily include fees from executing and clearing client transactions on stock, options and futures markets worldwide. These fees are recognized on a trade date basis. The Company records its share of the commission under certain clearing agreements where the Company is acting as agent for another broker, in accordance with EITF Statement No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent."

**Asset Management and Other Income**

The Company receives advisory fees for investment management. In addition, the Company receives performance incentive fees for managing certain funds. Advisory fees are recognized over the period of advisory service. Unearned advisory fees are treated as deferred revenues and are included in "Other liabilities" in the accompanying Condensed Consolidated Statements of Financial Condition. Performance incentive fees are accrued throughout the year based on a fund's performance to date against specified performance targets.

**THE BEAR STEARNS COMPANIES INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**Energy Trading**

Energy trading revenues are reported, net of certain direct costs, in "Principal transactions" revenues on the Condensed Consolidated Statements of Income. Energy trading assets and liabilities that are derivatives are reported at fair value with the corresponding changes recognized in income. Non-derivative contracts are accounted for on an accrual basis and recognized in income when the energy is delivered. See Note 16, "Asset Acquisition" for a further discussion on the assets acquired from the Williams Power Company, Inc.

**Financial Instruments**

The Company follows SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. Additionally, SFAS No. 157 disallows the use of block discounts on positions traded in an active market as well as nullifies certain guidance in EITF No. 02-3 regarding the recognition of inception gains on certain derivative transactions. See Note 2, "Financial Instruments" of Notes to Condensed Consolidated Financial Statements for a complete discussion of SFAS No. 157.

Financial instruments owned and financial instruments sold, but not yet purchased, including contractual commitments arising pursuant to futures, forward and option contracts, interest rate swaps and other derivative contracts, are recorded on a trade-date basis at fair value.

Fair value is generally based on quoted market prices. If quoted market prices are not available, fair value is determined based on other relevant factors, including dealer price quotations, price activity for equivalent instruments and valuation pricing models. Valuation pricing models consider time value, yield curve and volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other measurements.

Equity interests and securities acquired as a result of private equity and merchant banking activities are reflected in the Condensed Consolidated Financial Statements at fair value, which is often represented at initial cost until significant transactions or developments indicate that a change in the carrying value of the securities is appropriate. This represents the Company's best estimate of exit price as defined by SFAS No. 157. Generally, the carrying values of these securities will be increased based on company performance and in those instances where market values are readily ascertainable by reference to substantial transactions occurring in the marketplace or quoted market prices. Reductions to the carrying value of these securities are made when the Company's estimate of fair value has declined below the carrying value.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115," which provides a fair value option election that permits entities to irrevocably elect to measure financial assets and liabilities (except for those that are specifically scoped out of the Statement) at fair value as the initial and subsequent measurement attribute, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument.

Effective December 1, 2007, the Company adopted SFAS No. 159 and elected to apply the fair value option to liabilities of variable interest entities and mortgage loan special purpose entities. The primary reason for electing the fair value option is to simplify the accounting requirements. The Company did not have a transition adjustment upon the adoption of this Statement.

**Derivative Instruments and Hedging Activities**

The Company follows SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for stand-alone derivative instruments, derivatives embedded within other

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contracts or securities, and hedging activities. Accordingly, all derivatives, whether stand-alone or embedded within other contracts or securities, are carried in the Company's Condensed Consolidated Statements of Financial Condition at fair value, with changes in fair value recorded in "Principal transactions" revenues. Designated hedged items in fair value hedging relationships are marked for the risk being hedged, with such changes also recorded in "Principal transactions" revenues. Derivatives designated as cash flow hedges are carried at fair value. The effective portion of the change in fair value on a derivative designated as a cash flow hedge is reported in "Accumulated other comprehensive income (loss)." The ineffective portion is reported in "Principal transactions" revenues in the Condensed Consolidated Statements of Income. Amounts that are reported in "Accumulated other comprehensive income (loss)" are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.

The Company follows SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140." SFAS No. 155 permits companies to elect on an instrument-by-instrument basis, to apply a fair value measurement to hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation under SFAS No. 133. As permitted, on December 1, 2006, the Company elected to apply a fair value measurement to all existing hybrid financial instruments that met the SFAS No. 155 definition. The Company also elected the fair value measurement for certain qualifying hybrid financial instruments issued on or after December 1, 2006. The Company's reason for electing to carry these instruments on a fair value basis was to enable the Company to more efficiently hedge these instruments and to simplify the accounting process. Changes in fair value are reflected in "Principal transactions" revenues in the Condensed Consolidated Statements of Income.

The Company follows FIN No. 39, "Offsetting Amounts Related to Certain Contracts," and offsets assets and liabilities in the Condensed Consolidated Statements of Financial Condition provided that the legal right of offset exists under a master netting agreement. This includes the offsetting of payables or receivables relating to the fair value of cash collateral received or paid associated with its derivative inventory, on a counterparty by counterparty basis.

In April 2007, the FASB issued Staff Position ("FSP") FIN No. 39-1, "Amendment of FASB Interpretation No. 39." FSP FIN No. 39-1 defines "right of setoff" and specifies what conditions must be met for a derivative contract to qualify for this right of setoff. It also addresses the applicability of a right of setoff to derivative instruments and clarifies the circumstances in which it is appropriate to offset amounts recognized for those instruments in the Condensed Consolidated Statement of Financial Condition. In addition, this FSP permits offsetting of fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement and fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from the same master netting arrangement as the derivative instruments. The provisions of this FSP are consistent with the Company's current accounting practice. The Company adopted the provisions of FSP FIN No. 39-1 on December 1, 2007. The adoption of FSP FIN No. 39-1 did not impact the condensed consolidated financial statements of the Company.

### **Customer Transactions**

Customer securities transactions are recorded on the Condensed Consolidated Statements of Financial Condition on a settlement date basis, which is generally three business days after trade date, while the related commission revenues and expenses are recorded on a trade date basis. Receivables from and payables to customers include amounts related to both cash and margin transactions. Securities owned by customers, including those that collateralize margin or other similar transactions, are generally not reflected in the Condensed Consolidated Statements of Financial Condition.

### **Mortgage Servicing Rights**

Mortgage servicing rights ("MSRs") are included in "Other assets" on the Condensed Consolidated Statements of Financial Condition. The Company follows SFAS No. 156, "Accounting for Servicing of Financial Assets--an amendment of FASB Statement No. 140," and measures servicing assets at fair value. The fair value of MSRs is determined by using market-based models that discount anticipated future net cash flows considering loan

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prepayment predictions, interest rates, default rates, servicing costs, current market data and other economic factors. Changes in the fair value of MSRs are recorded in "Principal transactions" revenues in the Condensed Consolidated Statements of Income.

#### Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

The Company follows SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities--a replacement of FASB Statement No. 125," to account for securitizations and other transfers of financial assets and collateral. SFAS No. 140 establishes accounting and reporting standards with a financial-components approach that focuses on control. Under this approach, financial assets or liabilities are recognized when control is established and derecognized when control has been surrendered or the liability has been extinguished. Control is deemed to be relinquished only when all of the following conditions have been met: (1) the assets have been isolated from the transferor, even in bankruptcy or other receivership; (2) the transferee is a QSPE or has the right to pledge or exchange the assets received; and

(3) the transferor has not maintained effective control over the transferred assets. The Company derecognizes financial assets transferred in securitizations provided that such transfer meets all of these criteria.

Mortgage securitization transactions, net of certain direct costs, are recorded in "Principal transactions" revenues in the Condensed Consolidated Statements of Income.

#### Collateralized Securities Transactions

Transactions involving purchases of securities under agreements to resell ("reverse repurchase agreements") or sales of securities under agreements to repurchase ("repurchase agreements") are treated as collateralized financing transactions and are recorded at their contracted resale or repurchase amounts plus accrued interest. Resulting interest income and expense is generally included in "Principal transactions" revenues in the Condensed Consolidated Statements of Income. Reverse repurchase agreements and repurchase agreements are presented in the Condensed Consolidated Statements of Financial Condition on a net-by-counterparty basis, where permitted by generally accepted accounting principles. It is the Company's general policy to take possession of securities or loans with a market value in excess of the principal amount loaned plus the accrued interest thereon, in order to collateralize reverse repurchase agreements. Similarly, the Company is generally required to provide securities or loans to counterparties to collateralize repurchase agreements. The Company's agreements with counterparties generally contain contractual provisions allowing for additional collateral to be obtained, or excess collateral returned. It is the Company's policy to value collateral and to obtain additional collateral, or to retrieve excess collateral from counterparties, when deemed appropriate.

Securities borrowed and securities loaned are recorded based upon the amount of cash collateral advanced or received. Securities borrowed transactions facilitate the settlement process and require the Company to deposit cash, letters of credit or other collateral with the lender. With respect to securities loaned, the Company receives collateral in the form of cash or other collateral. The amount of collateral required to be deposited for securities borrowed, or received for securities loaned, is an amount generally in excess of the market value of the applicable securities borrowed or loaned. The Company monitors the market value of securities borrowed and loaned, with excess collateral retrieved or additional collateral obtained, when deemed appropriate.

#### Fixed Assets

Depreciation of property and equipment is provided by the Company on a straight-line basis over the estimated useful life of the asset. Amortization of leasehold improvements is provided on a straight-line basis over the lesser of the estimated useful life of the asset or the remaining life of the lease.

#### Goodwill and Identifiable Intangible Assets

The Company accounts for goodwill and identifiable intangible assets under the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets." In accordance with this guidance, the Company does not amortize goodwill, but amortizes identifiable intangible assets over their useful lives. Goodwill is tested at least annually for impairment and identifiable intangible assets are tested for potential impairment whenever events or changes in

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circumstances suggest that the carrying value of an asset or asset group may not be fully recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." See Note 17, "Subsequent Events," of Notes to the Condensed Consolidated Financial Statements for further discussion.

**Earnings Per Share**

Earnings per share ("EPS") is computed in accordance with SFAS No. 128, "Earnings Per Share." Basic EPS is computed by dividing net income applicable to common shares, adjusted for costs related to vested shares under the Capital Accumulation Plan for Senior Managing Directors, as amended and restated ("CAP Plan"), as well as the effect of the redemption of preferred stock, by the weighted average number of common shares outstanding. Common shares outstanding includes vested units issued under certain stock compensation plans, which will be distributed as shares of common stock. Diluted EPS includes the determinants of basic EPS and, in addition, gives effect to dilutive potential common shares related to stock compensation plans.

**Stock-Based Compensation**

The Company follows SFAS No. 123 (R), "Share-Based Payment," to account for its stock-based compensation plans. SFAS No. 123 (R) is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." SFAS No. 123 (R) eliminated the ability to account for share-based compensation transactions using APB No. 25, and requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements using a fair value-based method.

**Cash Equivalents**

The Company has defined cash equivalents as liquid investments not held for sale in the ordinary course of business with original maturities of three months or less that are not part of the Company's trading inventory.

**Income Taxes**

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN No. 48 in the first quarter of 2008. See Note 13, "Income Taxes," of the Notes to Condensed Consolidated Financial Statements for a further discussion.

The Company and certain of its subsidiaries file a U.S. consolidated federal income tax return. The Company accounts for income taxes under the provisions of SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred income taxes are based on the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities. In addition, deferred income taxes are determined by the enacted tax rates and laws expected to be in effect when the related temporary differences are expected to be reversed.

**Translation of Foreign Currencies**

Assets and liabilities denominated in foreign currencies are translated at period end rates of exchange, while income statement items are translated at daily average rates of exchange during the fiscal period. Gains or losses on translation of the financial statements of foreign subsidiaries from their respective functional currency to the U.S. dollar are included, net of tax, on the Condensed Consolidated Statements of Comprehensive Income. Gains or losses resulting from foreign currency transactions are included in current earnings.

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**Accounting and Reporting Developments**

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133." The Statement requires companies to provide enhanced disclosures regarding derivative instruments and hedging activities. It requires companies to better convey the purpose of derivative use in terms of the risks that such company is intending to manage. Disclosures about

(a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect a company's financial position, financial performance, and cash flows are required. This Statement retains the same scope as SFAS No. 133 and is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently assessing implementation plans and does not expect the adoption of SFAS No. 161 to have a material impact, if any, on the Condensed Consolidated Financial Statements.

In February 2008, the FASB issued a FASB Staff Position ("FSP") on Accounting for Transfers of Financial Assets and Repurchase Financing Transactions "FSP FAS 140-3." This FSP addresses the issue of whether or not these transactions should be viewed as two separate transactions or as one "linked" transaction. The FSP includes a "rebuttable presumption" that presumes linkage of the two transactions unless the presumption can be overcome by meeting certain criteria. The FSP will be effective for fiscal years beginning after November 15, 2008 and will apply only to original transfers made after that date; early adoption will not be allowed. The Company is currently evaluating the impact, if any, the adoption of this interpretation will have on the Company's Condensed Consolidated Financial Statements.

In December 2007, the FASB issued Statement No. 141R, "Business Combinations (a revision of Statement No. 141)." This Statement applies to all transactions or other events in which an entity obtains control of one or more businesses, including those combinations achieved without the transfer of consideration. This Statement retains the fundamental requirements in Statement No. 141 that the acquisition method of accounting be used for all business combinations. This Statement expands the scope to include all business combinations and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their fair values as of the acquisition date. Additionally, SFAS No. 141R changes the way entities account for business combinations achieved in stages by requiring the identifiable assets and liabilities to be measured at their full fair values. Additionally, contractual contingencies and contingent consideration shall be measured at fair value at the acquisition date. This Statement is effective on a prospective basis to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of this Statement will have on the Condensed Consolidated Financial Statements of the Company.

In December 2007, the FASB issued Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51". This Statement amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Additionally, this Statement requires that consolidated net income include the amounts attributable to both the parent and the noncontrolling interest. This Statement is effective for interim periods beginning on or after December 15, 2008. The Company is currently evaluating the impact, if any, that the adoption of this Statement will have on the Condensed Consolidated Financial Statements of the Company.

In June 2007, the EITF issued EITF Issue No. 06-11 "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." This issue requires that the tax benefits related to dividend equivalents paid on restricted stock units, which are expected to vest, be recorded as an increase to additional paid-in capital. EITF 06-11 is effective prospectively to the income tax benefits on dividends declared in fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact, if any, the adoption of this issue may have on the Company's Condensed Consolidated Financial Statements and does not expect that the adoption of this issue will have a material impact on the Condensed Consolidated Financial Statements.

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In December 2007, the American Securitization Forum published a Streamlined Foreclosure and Loss Avoidance Framework (ASF Framework) to enable mortgage servicers to streamline their loss avoidance and loan modification practices. The framework is an industry-developed, recommended methodology that servicers of securitized subprime ARMS held in QSPEs can use to fulfill their existing obligations to service those loans in a faster and more efficient manner while maximizing recoveries for the benefit of securitization investors. The ASF Framework applies to all first lien subprime residential ARMs that have an initial fixed rate period of 36 months or less that were originated between January 1, 2005 and July 31, 2007, and that have an initial interest rate reset between January 1, 2008 and July 31, 2010.

Under the ASF Framework, the covered loans are divided into three segments:

Segment 1 - includes current loans where the borrower is likely to be able to refinance into any available mortgage product, including FHA, FHA Secure or readily available mortgage industry products;

Segment 2 - includes current loans where the borrower is unlikely to be able to refinance into any readily available mortgage industry product; and

Segment 3 - includes loans where the borrower is not current as defined above, demonstrating difficulty meeting the introductory rate.

The methodology prescribed in the ASF Framework applies to those loans in Segment 2, in advance of the initial reset date. Those loans would be eligible for a "fast track" loan modification under which the interest rate would be kept at the existing rate, generally for five years following the upcoming reset. The ASF Framework provides a methodology which complies with relevant tax regulations and off-balance-sheet accounting standards for QSPEs. Moreover, the SEC's Office of Chief Accountant has concluded that it will not object to continued status as a QSPE if Segment 2 subprime ARM loans are modified pursuant to the specific screening criteria in the ASF Framework. The Company adopted the ASF screening criteria in the first quarter of 2008, and believes that the modification of loans in accordance with the ASF Framework does not impact the off-balance-sheet accounting treatment of QSPEs that hold subprime ARM loans.

While a uniform definition of subprime mortgages does not exist in the marketplace, the Company defines subprime primarily as loans issued to higher risk borrowers who do not qualify for the best market interest rates because of their deficient credit history. Although FICO credit scores and prior mortgage or rent payment histories are the main drivers of a subprime designation, subprime also includes borrowers that have had a recent foreclosure or bankruptcy. Other considerations include borrower's reserve funds, residual household income and debt to income ratio. The Company has not yet modified a significant percentage of loans using the ASF Framework; accordingly, the impact to the Company's retained interest has been immaterial.

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2. FINANCIAL INSTRUMENTS

Financial instruments owned and financial instruments sold, but not yet purchased, consisting of the Company's proprietary trading inventories, at fair value, were as follows:

(in millions)	February 29, 2008	November 30, 2007
-----		
FINANCIAL INSTRUMENTS OWNED, AT FAIR VALUE:		
U.S. government and agency	\$ 21,310	\$ 12,920
Other sovereign governments	2,394	672
Corporate equity and convertible debt	26,975	32,454
Corporate debt and other	23,511	26,330
Mortgages, mortgage- and asset-backed	38,186	46,141
Derivative financial instruments	28,728	19,725
-----		
	\$ 141,104	\$ 138,242
=====		

**FINANCIAL INSTRUMENTS SOLD, BUT NOT YET PURCHASED,  
AT FAIR VALUE:**

U.S. government and agency	\$ 9,718	\$ 4,563
Other sovereign governments	1,189	2,473
Corporate equity and convertible debt	18,700	18,843
Corporate debt and other	5,079	4,373
Mortgages, mortgage- and asset-backed	348	63
Derivative financial instruments	16,510	13,492
-----		
	\$ 51,544	\$ 43,807
=====		

As of February 29, 2008 and November 30, 2007, all financial instruments owned that were pledged to counterparties where the counterparty has the right, by contract or custom, to rehypothecate those securities are classified as "Financial instruments owned and pledged as collateral, at fair value" in the Condensed Consolidated Statements of Financial Condition.

Financial instruments sold, but not yet purchased, at fair value represent obligations of the Company to purchase the specified financial instrument at the then current market price. Accordingly, these transactions result in off-balance-sheet risk as the Company's ultimate obligation to repurchase such securities may exceed the amount recognized in the Condensed Consolidated Statements of Financial Condition.

**Concentration Risk**

The Company is subject to concentration risk by holding large positions or committing to hold large positions in certain types of securities, securities of a single issuer (including governments), issuers located in a particular country or geographic area, or issuers engaged in a particular industry. Positions taken and commitments made by the Company, including underwritings, often involve substantial amounts and significant exposure to individual issuers and businesses, including non-investment-grade issuers. At February 29, 2008 and November 30, 2007, the Company's most significant concentrations were related to United States government securities, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation agency-backed securities, which are included in the U.S. government and agency and Mortgages, mortgage-and asset-backed inventory captions above. In addition, a substantial portion of the collateral held by the Company for reverse repurchase agreements consists of securities issued by the U.S. government and agencies.

**Fair Value Measurements**

The Company follows SFAS No. 157, "Fair Value Measurements." SFAS No. 157 applies to all financial instruments that are measured and reported on a fair value basis. This includes those items currently reported in "Financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value" on

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the Condensed Consolidated Statements of Financial Condition as well as financial instruments reported in "Other assets" and "Other liabilities" captions that are reported at fair value below.

As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as exchange-traded derivatives and listed equities. This category also includes financial instruments that are valued using alternative approaches but for which the Company typically receives independent external valuation information including U.S. Treasuries, other U.S. Government and agency securities, and certain cash instruments such as money market funds and certificates of deposit.

Level 2 includes financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category include sovereign debt, certain corporate equities, corporate debt, certain U.S. agency and non-agency mortgage-backed securities and non-exchange-traded derivatives such as interest rate swaps.

Level 3 is comprised of financial instruments whose fair value is estimated based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable. Included in this category are distressed debt, non-performing mortgage-related assets, certain performing residential and commercial mortgage loans, certain mortgage- and asset-backed securities and residual interests, Chapter 13 and other credit card receivables from individuals, and complex derivative structures including long-dated equity derivatives.

In determining the appropriate levels, the Company performs a detailed analysis of the assets and liabilities that are subject to SFAS No. 157. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

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**Fair Value Measurements on a Recurring Basis as of February 29, 2008:**

(in millions)	Level 1	Level 2	Level 3	Impact of Netting	Balance as of February 29, 2008
Financial Instruments Owned, at fair value					
U.S. government and agency	\$ 5,857	\$ 15,453	\$ --	\$ --	\$ 21,310
Other sovereign governments	--	2,394	--	--	2,394
Corporate equity and convertible debt	19,798	6,830	347	--	26,975
Corporate debt and other	14	18,373	5,124	--	23,511
Mortgages, mortgage- and asset-backed	--	15,966	22,220	--	38,186
<b>Total Non Derivative Trading Assets</b>	<b>25,669</b>	<b>59,016</b>	<b>27,691</b>	<b>--</b>	<b>112,376</b>
Derivative financial instruments (1)	202	272,356	6,276	(250,106 )	28,728
<b>Total Financial Instruments Owned, at fair value</b>	<b>25,871</b>	<b>331,372</b>	<b>33,967</b>	<b>(250,106 )</b>	<b>141,104</b>
Other Assets(2)	391	1,607	3,383	--	5,381
<b>Total Assets at fair value</b>	<b>\$ 26,262</b>	<b>\$ 332,979</b>	<b>\$ 37,350</b>	<b>\$ (250,106 )</b>	<b>\$ 146,485</b>

(in millions)	Level 1	Level 2	Level 3	Impact of Netting	Balance as of February 29, 2008
Financial Instruments Sold But Not Yet Purchased, at fair value					
U.S. government and agency	\$ (9,718)	\$ --	\$ --	\$ --	\$ (9,718)
Other sovereign governments	--	(1,189)	--	--	(1,189)
Corporate equity and convertible debt	(16,554)	(2,145)	(1)	--	(18,700)
Corporate debt and other	--	(5,053)	(26)	--	(5,079)
Mortgages, mortgage- and asset-backed	--	(348)	--	--	(348)
<b>Total Non Derivative Trading Liabilities</b>	<b>(26,272)</b>	<b>(8,735)</b>	<b>(27)</b>	<b>--</b>	<b>(35,034)</b>
Derivative financial instruments (1)	(185)	(254,426)	(5,096)	243,197	(16,510)
<b>Total Financial Instruments Sold But Not Yet Purchased, at fair value</b>	<b>(26,457)</b>	<b>(263,161)</b>	<b>(5,123)</b>	<b>243,197</b>	<b>(51,544)</b>
Other Liabilities(3)	(82)	(7,715)	(1,739)	--	(9,536)
<b>Total Liabilities at fair value</b>	<b>\$ (26,539)</b>	<b>\$ (270,876)</b>	<b>\$ (6,862)</b>	<b>\$ 243,197</b>	<b>\$ (61,080)</b>

(1) The derivatives trading inventory balances are reported on a gross basis by level with a corresponding adjustment for netting.

(2) Other assets includes certain items such as alternative investments, mortgage servicing rights, net assets of variable interest entities and mortgage securitizations that did not meet the criteria for sale treatment under SFAS No. 140.

(3) Other liabilities are primarily comprised of certain hybrid debt issuances accounted for at fair value as elected in accordance with SFAS No. 155.

As stated above SFAS No. 157 applies to all financial assets and liabilities that are reported on a fair value basis. These valuations are adjusted for various factors including credit risk. For applicable financial assets carried at fair value, the credit standing of the counterparties is analyzed and factored into the fair value measurement of those assets. SFAS No. 157 states that the fair value measurement of a liability must reflect the nonperformance risk of the entity. Therefore, the impact of credit standing as well as any potential credit enhancements (e.g. collateral) has been factored into the fair value measurement of both financial assets and liabilities.

The non-derivative trading inventory category includes securities such as U.S. Government and agency, other sovereign governments, corporate equities, convertible debt, corporate debt, mortgages, mortgage- and asset-backed, as well as certain other items. They are reported in "Financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value" on the Condensed Consolidated Statements of Financial Condition. The derivatives trading inventory balances in the table above are reported on a gross basis by level with a netting adjustment presented separately in the "Impact of Netting" column. The Company often enters into different types of derivative contracts with a single counterparty and these contracts are covered under one ISDA master

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netting agreement. The fair value of the individual derivative contracts are reported gross in their respective levels based on the fair value hierarchy.

Other assets and other liabilities represent those financial assets and liabilities that the Company carries at fair value but are not included in "Financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value" captions. Other assets includes certain items such as alternative investments, mortgage servicing rights, net assets of VIEs and mortgage securitizations that did not meet the criteria for sale treatment under SFAS No. 140. Other liabilities is primarily comprised of certain hybrid debt issuances accounted for at fair value as elected in accordance with SFAS No. 155.

The following tables provide a reconciliation of the beginning and ending balances for the major classes of assets and liabilities measured at fair value using significant unobservable inputs (Level 3):

Level 3 Financial Assets and Liabilities Three months ended February 29, 2008

(in millions)	Beginning Balance as of December 1, 2007	Total Gains/ (Losses) (Realized and Unrealized)	Purchases, Issuances, Sales and Settlements	Transfers In/Out of Level 3	Ending Balance as of February 29, 2008	Changes in Unrealized Gains/(Losses) relating to Assets and Liabilities held at the reporting date
Non-Derivative Trading Assets	\$ 22,080	\$ (1,435)	\$ 118	\$ 6,928	\$ 27,691	\$ (1,527)
Non Derivative Trading Liabilities	\$ (58)	\$ (6)	\$ 23	\$ 14	\$ (27)	\$ 11
Derivative Trading Inventory (Net)	\$ (589)	\$ 763	\$ 290	\$ 716	\$ 1,180	\$ 812
Other Assets	\$ 3,758	\$ (369)	\$ (165)	\$ 159	\$ 3,383	\$ (375)
Other Liabilities	\$ (1,254)	\$ 142	\$ (47)	\$ (580)	\$ (1,739)	\$ 166

**Non-Derivative Trading Assets and Liabilities**

Realized and unrealized gains and losses on Level 3 assets and liabilities are primarily reported in "Principal transactions" revenues in the Condensed Consolidated Statements of Income. The Level 3 non-derivative trading assets reflect an unrealized loss related to the mortgage related inventory write-downs incurred during the first quarter of 2008. The Company manages its exposure on a portfolio basis and regularly engages in offsetting strategies in which financial instruments from one fair value hierarchy level are used to economically offset the risk of financial instruments in the same or different levels. Therefore, realized and unrealized gains and losses reported as Level 3 may be offset by gains or losses attributable to assets or liabilities classified in Level 1 or Level 2.

**Derivative Trading Inventory (Net)**

The net derivative trading inventory resulted in a gain for the first quarter of 2008. This gain was primarily driven by changes in interest rates and credit spreads related to the Company's interest rate and credit derivative products.

**Transfers**

The Company reviews the fair value hierarchy classifications on a monthly basis. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in/out of Level 3 at fair value in the month in which the changes occur.

During the 2008 quarter, there were approximately \$6.9 billion of non-derivative trading assets transferred from level 2 to level 3. These transfers were primarily related to mortgages and mortgage-backed securities. The largest

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contributors to the transfers were performing residential mortgages and investment-grade mortgage-backed securities. Additionally, during the 2008 quarter, there were approximately \$700 million of net derivative trading assets which transferred from level 2 to level 3. These transfers were primarily related to mortgage-related credit default swaps.

These transfers were driven by the continued market and liquidity deterioration in the mortgage markets.

**Fair Value Option**

SFAS No. 159 provides a fair value option election that permits entities to irrevocably elect to measure financial assets and liabilities (except for those that are specifically scoped out of the Statement) at fair value as the initial and subsequent measurement attribute, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument.

Effective December 1, 2007, the Company adopted SFAS No. 159 and elected to apply the fair value option to liabilities of variable interest entities and mortgage loan special purpose entities. Incorporated in the SFAS No. 159 guidance are specific disclosure requirements related to the hybrid financial instruments elected under SFAS No. 155.

In accordance with SFAS No. 155, the Company measures certain hybrid financial instruments at fair value. These hybrid financial instruments are recorded in "Long-term borrowings" and "Unsecured short-term borrowings" in the Condensed Consolidated Statements of Financial Condition. Changes in the fair value of these hybrid financial instruments, including interest, are reflected in "Principal transactions" revenues in the Condensed Consolidated Statements of Income. Gains (losses) related to changes in the fair value of these hybrid financial instruments classified as Long term borrowings amounted to \$639 million and \$337 million for the three months ended February 29, 2008 and February 28, 2007 respectively, of which \$305 million and \$35 million were attributable to the widening of the Company's credit spreads and were derived from the Company's bond market spreads during the respective periods. Gains (losses) related to changes in the fair value of these hybrid financial instruments classified as Unsecured short-term borrowings were not material for the three months ended February 29, 2008 and February 28, 2007. As of February 29, 2008 and November 30, 2007, the aggregate principal balance classified as Long term borrowings, exceeded the aggregate fair value by \$1.8 billion and \$547 million, respectively. As of February 29, 2008 and November 30, 2007, the aggregate principal balance classified as Unsecured short-term borrowings, exceeded the aggregate fair value by approximately \$224 million and \$203 million, respectively. As a result of the events described in Note 17, "Subsequent Events" of Notes to the Condensed Consolidated Financial Statements, approximately \$372 million in losses were recognized during the month ended March 31, 2008, due to tightening of the Company's credit spreads.

### 3. DERIVATIVES AND HEDGING ACTIVITIES

The Company, in its capacity as a dealer in over-the-counter derivative financial instruments and its proprietary market-making and trading activities, enters into transactions in a variety of cash and derivative financial instruments for proprietary trading and to manage its exposure to market and credit risk. These risks include interest rate, exchange rate, equity price, and commodity price risk. Derivative financial instruments represent contractual commitments between counterparties that derive their value from changes in an underlying interest rate, currency exchange rate, index (e.g., Standard & Poor's 500 Index), reference rate (e.g., London Interbank Offered Rate, or LIBOR), or asset value referenced in the related contract. Some derivatives, such as futures contracts, certain options and index-referenced warrants, can be traded on an exchange. Other derivatives, such as interest rate and currency swaps, caps, floors, collars, swaptions, equity swaps and options, credit derivatives, structured notes and forward contracts, are negotiated in the over-the-counter markets. Derivatives generate both on- and off-balance-sheet risks depending on the nature of the contract. Generally, these financial instruments represent commitments or rights to exchange interest payment streams or currencies or to purchase or sell other securities at specific terms at specified future dates. Option contracts generally provide the holder with the right, but not the obligation, to purchase or sell a financial instrument at a specific price on or before an established date or dates. Financial

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instruments sold, but not yet purchased may result in market and/or credit risk in excess of amounts recorded in the Condensed Consolidated Statements of Financial Condition.

**Market Risk**

Derivative financial instruments involve varying degrees of off-balance-sheet market risk, whereby changes in the level or volatility of interest rates, foreign currency exchange rates or market values of the underlying financial instruments may result in changes in the value of a particular financial instrument in excess of the amounts currently reflected in the Condensed Consolidated Statements of Financial Condition. The Company's exposure to market risk is influenced by a number of factors, including the relationships among and between financial instruments with off-balance-sheet risk, the Company's proprietary securities, futures and derivatives inventories as well as the volatility and liquidity in the markets in which the financial instruments are traded. The Company mitigates its exposure to market risk by entering into offsetting transactions, which may include over-the-counter derivative contracts or the purchase or sale of interest-bearing securities, equity securities, financial futures and forward contracts. In this regard, the utilization of derivative instruments is designed to reduce or mitigate market risks associated with holding dealer inventories or in connection with arbitrage-related trading activities.

**Derivatives Credit Risk**

Credit risk arises from the potential inability of counterparties to perform in accordance with the terms of the contract. At any point in time, the Company's exposure to credit risk associated with counterparty non-performance is generally limited to the net replacement cost of over-the-counter contracts, net of the value of collateral held. Such financial instruments are reported at fair value on a net-by-counterparty basis pursuant to enforceable netting agreements. Exchange-traded financial instruments, such as futures and options, generally do not give rise to significant unsecured counterparty exposure due to margin requirements of the exchanges, as well as the Company's internal margin requirements, which may be greater than those prescribed by the individual exchanges. Options written by the Company generally do not give rise to counterparty credit risk since they obligate the Company (not its counterparty) to perform.

The Company has controls in place to monitor credit exposures by assessing the future creditworthiness of counterparties and limiting transactions with specific counterparties. The Company also seeks to control credit risk by following an established credit approval process, monitoring credit limits and requiring collateral where appropriate.

**Hedging Activity**

To modify the interest rate characteristics of its long- and short-term debt, the Company also engages in non-trading derivatives activities. The Company has issued U.S. dollar- and foreign currency-denominated debt with both variable- and fixed-rate interest payment obligations. The Company has entered into interest rate swaps, primarily based on LIBOR, to convert fixed-rate interest payments on its debt obligations into variable-rate payments. In addition, for foreign currency debt obligations that are not used to fund assets in the same currency, the Company has entered into currency swap agreements that effectively convert the debt into U.S. dollar obligations. Such transactions are accounted for as fair value hedges.

These financial instruments are subject to the same market and credit risks as those that are traded in connection with the Company's market making and trading activities. The Company has similar controls in place to monitor these risks.

SFAS No. 133, as amended by SFAS No. 138 and SFAS No. 149, establishes accounting and reporting standards for stand-alone derivative instruments, derivatives embedded within other contracts or securities and for hedging activities. It requires that all derivatives, whether standalone or embedded within other contracts or securities be carried on the Company's Condensed Consolidated Statements of Financial Condition at fair value. SFAS No. 133 also requires the value of items designated as being fair value hedged to be adjusted for the risk being hedged, as defined in SFAS No. 133, provided that the intent to hedge is fully documented. Any resultant net change in value for both the hedging derivative and the hedged item for the risk being hedged is recognized in earnings immediately,

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such net effect being deemed the "ineffective" portion of the hedge. The gains and losses associated with the ineffective portion of the fair value hedges are included in "Principal transactions" revenues in the Condensed Consolidated Statements of Income. These amounts were immaterial for the three months ended February 29, 2008.

The Company also engages in non-trading derivative activities to manage commodity price risks resulting from exposures to changes in spot and forward prices in electricity and natural gas. The Company actively manages these risks with exchange traded futures, swaps, OTC swaps and options. Certain of these transactions are accounted for as cash flow hedges as defined in SFAS No. 133 which requires the effective portion of the unrealized gain or loss on a derivative designated as a cash flow hedge, as defined in SFAS No. 133, to be reported in "Accumulated other comprehensive income" ("OCI") with the ineffective portion reported in "Principal transactions" revenues in the Condensed Consolidated Statements of Income. Amounts that are reported in OCI are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of cash flow hedges was deemed immaterial for the three months ended February 29, 2008.

The net gain on derivative instruments designated in cash flow hedging relationships recorded in OCI, net of tax, was \$25 million at February 29, 2008. The net increase in fair value recorded in OCI in the first quarter of 2008 was \$35 million. The net gain in OCI is expected to be reclassified into earnings as follows: \$6 million in fiscal 2008 and the remaining \$19 million of gains within five years.

#### 4. TRANSFERS OF FINANCIAL ASSETS AND LIABILITIES

##### **Securitizations**

The Company is a market leader in mortgage-backed securitization and other structured financing arrangements. In the normal course of business, the Company regularly securitizes commercial and residential mortgages, consumer receivables and other financial assets. Securitization transactions are generally treated as sales, provided that control has been relinquished. In connection with securitization transactions, the Company establishes special-purpose entities ("SPEs"), in which transferred assets, including commercial and residential mortgages, consumer receivables and other financial assets are sold to an SPE and repackaged into securities or similar beneficial interests. Transferred assets are accounted for at fair value prior to securitization. The majority of the Company's involvement with SPEs relates to securitization transactions meeting the definition of a QSPE under the provisions of SFAS No. 140. Provided it has relinquished control over such assets, the Company derecognizes financial assets transferred in securitizations and does not consolidate the financial statements of QSPEs. For SPEs that do not meet the QSPE criteria, the Company uses the guidance in FIN No. 46 (R) to determine whether the SPE should be consolidated.

In connection with these securitization activities, the Company may retain interests in securitized assets in the form of senior or subordinated securities or as residual interests. Retained interests in securitizations are generally not held to maturity and typically are sold shortly after the settlement of a securitization. The weighted average holding period for retained interest positions in inventory at February 29, 2008 and November 30, 2007 was approximately 210 days and 180 days, respectively. These retained interests are included in "Financial instruments owned, at fair value" in the Condensed Consolidated Statements of Financial Condition and are carried at fair value. Consistent with the valuation of similar inventory, fair value is determined by broker-dealer price quotations and internal valuation pricing models that utilize variables such as yield curves, prepayment speeds, default rates, loss severity, interest rate volatilities and spreads. The assumptions used for pricing variables are based on observable transactions in similar securities and are further verified by external pricing sources, when available.

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The Company's securitization activities are detailed below:

(in billions)	Agency Mortgage-Backed	Other Mortgage- and Asset-Backed	Total
-----			
Total securitizations			
Three months ended February 29, 2008	\$5.4	\$3.9	\$9.3
Three months ended February 28, 2007	\$4.7	\$21.3	\$26.0
-----			

The following table summarizes the Company's retained interests by rating as of February 29, 2008 and November 30, 2007:

(in billions)	February 29, 2008	November 30, 2007
-----		
Retained Interests:		
AAA rated Agency Mortgage-Backed	\$2.6	\$2.4
AAA rated Other Mortgage and Asset-Backed	2.9	2.7
-----		
Total AAA rated	\$5.5	\$5.1
Other investment grade	1.4	1.6
Non-investment grade	1.3	1.3
-----		
Total retained interests	\$8.2	\$8.0
=====		

The following table summarizes cash flows from securitization trusts related to securitization transactions during the three months ended February 29, 2008 and February 28, 2007:

(in millions)	Agency Mortgage- Backed	Other Mortgage- and Asset- Backed	Total
-----			
Cash flows received from retained interests			
Three months ended February 29, 2008	\$10.1	\$1.2	\$11.3
Three months ended February 28, 2007	\$13.5	\$78.3	\$91.8
Cash flows from servicing			
Three months ended February 29, 2008	\$ -	\$5.1	\$5.1
Three months ended February 28, 2007	\$ -	\$4.5	\$4.5
-----			

The Company is an active market maker in mortgage-backed securities and therefore may retain interests in assets it securitizes, predominantly highly rated or government agency-backed securities. The models employed in the valuation of retained interests consider possible changes in prepayment speeds in response to changes in future interest rates, as well as potential credit losses. Prepayment speed changes are incorporated by calibrating the distribution of possible future interest rates to the observed levels of implied volatility in the market for interest rate options and generating the corresponding cash flows for the securities using prepayment models. Credit losses are considered through explicit loss models for positions exposed to significant default risk in the underlying collateral, and through option-adjusted spreads that also incorporate additional factors such as liquidity and model uncertainty for all positions. The models use discount rates that are based on the Treasury curve, plus the option-adjusted spread. Key points on the constant maturity Treasury curve at February 29, 2008 were 1.63% for 2-year Treasuries and 3.78% for 10-year Treasuries, and ranged from 1.57% to 4.44%. The weighted average spread was 207 basis points and 561 basis points for agency mortgage-backed securities and other mortgage- and asset-backed securities, respectively, at February 29, 2008.

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Weighted key economic assumptions used in measuring the fair value of retained interests in assets the Company securitized at February 29, 2008 were as follows:

	Agency Mortgage- Backed	Other Mortgage- and Asset- Backed
Weighted average life (years)	5.9	3.1
Average prepayment speeds (annual rate)	8% - 36%	8% - 40%
Credit losses	-	0.9% - 53%

The following hypothetical sensitivity analysis as of February 29, 2008 illustrates the potential adverse change in fair value of these retained interests due to a specified change in the key valuation assumptions. The interest rate changes represent a parallel shift in the Treasury curve. This shift considers the corresponding effect of other variables, including prepayments. The remaining valuation assumptions are changed independently. Retained interests in securitizations are generally not held to maturity and are typically sold shortly after the settlement of a securitization. The Company considers the current and expected credit profile of the underlying collateral in determining the fair value and periodically updates the fair value for changes in credit, interest rate, prepayment speeds and other pertinent market factors. Changes in portfolio composition, updates to loss and prepayment models, and changes in the level of interest rates and market prices for retained interests, can combine to produce significant changes in the sensitivities reported even if aggregate market values do not change significantly. Actual credit losses on retained interests have not been significant.

(in millions)	Agency Mortgage- Backed	Other Mortgage- and Asset- Backed
<b>Interest rates</b>		
Impact of 50 basis point adverse change	\$ (78)	(113)
Impact of 100 basis point adverse change	(167)	(232)
<b>Prepayment speeds</b>		
Impact of 10% adverse change	(5)	(33)
Impact of 20% adverse change	(10)	(58)
<b>Credit losses</b>		
Impact of 10% adverse change	(18)	(161)
Impact of 20% adverse change	(36)	(294)

The above table should be viewed with caution since the changes in a single variable generally cannot occur without changes in other variables or conditions that may counteract or amplify the effect of the changes outlined in the table. Changes in fair value based on adverse variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value is not usually linear. In addition, the table does not consider the change in fair value of offsetting positions, which would generally offset the changes detailed in the table, nor does it consider any corrective action that the Company may take in response to changes in these conditions. The impact of offsetting positions is not presented because these positions are established on a portfolio level and allocating the impact would not be practicable.

### Mortgage Servicing Rights

In the normal course of business, the Company originates and purchases conforming and non-conforming, conventional fixed-rate and adjustable-rate residential mortgage loans and sells such loans to investors. In connection with these activities, the Company may retain MSRMs that entitle the Company to a future stream of cash flows based on the contractual servicing fee. In addition, the Company may purchase and sell MSRMs.

The Company follows SFAS No. 156 and carries its MSRMs at fair value, with changes in fair value reported in earnings.

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The determination of fair value of the Company's MSR's requires management judgment because they are not actively traded. The determination of fair value for MSR's requires valuation processes which combine the use of discounted cash flow models and extensive analysis of current market data to arrive at an estimate of fair value. The cash flow and prepayment assumptions used in the Company's discounted cash flow model are based on empirical data drawn from the historical performance of the Company's MSR's adjusted to reflect current Market conditions, which the Company believes are consistent with assumptions used by market participants valuing similar MSR's. The key risks and therefore the key assumptions used in the valuation of MSR's include mortgage prepayment speeds and the discount rates. These variables can, and generally will, change from quarter to quarter as market conditions and projected interest rates change. The Company mitigates the income statement effect of changes in fair value of MSR's by entering into economic offsetting transactions.

At February 29, 2008, the key economic assumptions and the sensitivity of the current fair value of MSR's to immediate changes in those assumptions were as follows:

(in millions)	February 29, 2008
Fair value of MSR's	\$ 771
Weighted average constant prepayment rate (CPR)	10.7%
Impact on fair value of:	
10% adverse change	\$ (30)
20% adverse change	(51)
Weighted average discount rate	13.3%
Impact on fair value of:	
10% adverse change	\$ (24)
20% adverse change	(46)
Weighted average constant default rate (CDR)	7.7%
Impact on fair value of:	
10% adverse change	\$ (25)
20% adverse change	(48)

The above table should be viewed with caution since the changes in a single variable generally cannot occur without changes in other variables or conditions that may counteract or amplify the effect of the changes outlined in the table. Changes in fair value based on adverse variations in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value is not usually linear. In addition, the table does not consider the change in fair value of offsetting positions, which would generally offset the changes detailed in the table, nor does it consider any corrective action that the Company may take in response to changes in these conditions. The impact of offsetting positions is not presented because these positions are established on a portfolio level and allocating the impact would not be practicable.

MSR's are included in "Other assets" on the Condensed Consolidated Statements of Financial Condition and are carried at fair value in accordance with SFAS No. 156. The Company's MSR's activities for the three months ended February 29, 2008 and February 28, 2007 were as follows:

(in millions)	February 29, 2008	February 28, 2007
Balance, beginning of period	\$ 833	\$ 502
Additions	2	112
Paydowns	(23)	(39)
Changes in fair value resulting from changes in valuation inputs/assumptions	(41)	5
Balance, end of period	\$ 771	\$ 580

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**5. VARIABLE INTEREST ENTITIES AND MORTGAGE LOAN SPECIAL PURPOSE ENTITIES**

The Company regularly creates or transacts with entities that may be variable interest entities (VIEs). These entities are an essential part of the Company's securitization, asset management and structured finance businesses. In addition, the Company purchases and sells financial instruments that may be variable interests. The Company follows the guidance in FIN No. 46(R) and consolidates those VIEs in which the Company is the primary beneficiary.

The Company may perform various functions, including acting as the seller, servicer, investor, structurer or underwriter in securitization transactions. These transactions typically involve entities that are considered to be QSPEs, as defined in SFAS No. 140. QSPEs are exempt from the requirements of FIN No. 46 (R). For securitization vehicles that do not qualify as QSPEs, the holders of the beneficial interests have no recourse to the Company, only to the assets held by the related VIE. In certain of these VIEs, the Company could be determined to be the primary beneficiary through its ownership of certain beneficial interests, and would, therefore, be required to consolidate the assets and liabilities of the VIE.

The Company has mortgage securitizations that did not meet the criteria for sale treatment under SFAS No. 140, including transactions where the retained call option did not meet the definition of a clean up call under SFAS No. 140. As such, the Company continues to carry the assets and liabilities from these transactions on its Condensed Consolidated Statements of Financial Condition.

The Company acts as portfolio manager and/or underwriter in several collateralized debt obligation and collateralized loan obligation transactions. In these transactions, the Company establishes a trust that purchases a portfolio of assets and issues trust certificates that represent interests in the portfolio of assets. The holders of the trust certificates have recourse only to the underlying assets of the trusts and not to the Company's other assets. In addition, the Company may receive variable compensation for managing the portfolio and may also retain certain trust certificates. In certain of these transactions, these interests result in the Company becoming the primary beneficiary of these entities.

The Company establishes and operates funds for the benefit of its employees. These funds are considered to be VIEs of which the Company is the primary beneficiary.

The Company has made investments in entities that own power plants. Certain entities are VIEs of which the Company is the primary beneficiary.

The following table sets forth the Company's total assets and maximum exposure to loss associated with its significant variable interests in consolidated VIEs and securitizations that did not qualify for sale treatment. This information is presented based on principal business activity.

(in millions)	As of February 29, 2008		As of November 30, 2007	
	VIE Assets	Maximum Exposure to Loss (1)	VIE Assets	Maximum Exposure to Loss (1)
Mortgage Securitizations	\$ 27,322	\$ 2,522	\$ 30,313	\$ 2,075
Collateralized Debt and Loan Obligations	1,639	173	2,150	297
Employee Funds(2)	625	429	650	445
Energy Investments	405	128	440	131
<b>Total</b>	<b>\$ 29,991</b>	<b>\$ 3,252</b>	<b>\$ 33,553</b>	<b>\$ 2,948</b>

(1) Represents the fair value of the Company's interest in these entities.

(2) Maximum exposure to loss includes loans the Company has made to employees who participate in the funds, for which the Company is in a second loss position.

The Company also owns significant variable interests in several VIEs related to collateralized debt obligations and collateralized loan obligations for which the Company is not the primary beneficiary and therefore does not consolidate these entities. In aggregate, these VIEs had assets of approximately \$5.8 billion and \$11.5 billion at

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February 29, 2008 and November 30, 2007, respectively. At February 29, 2008 and November 30, 2007, the Company's maximum exposure to loss from these entities was approximately \$61 million and \$112 million, respectively, which represents the fair value of its interests and are included in "Financial instruments owned, at fair value" in the Condensed Consolidated Statements of Financial Condition.

The Company purchases and sells interests in entities that may be deemed to be VIEs in its market-making capacity in the ordinary course of business. As a result of these activities, it is reasonably possible that such entities may be consolidated or deconsolidated at various points in time. Therefore, the Company's variable interests included above may not be held by the Company in future periods.

#### 6. COLLATERALIZED FINANCING ARRANGEMENTS

The Company enters into secured borrowing and lending agreements to obtain collateral necessary to effect settlements, finance inventory positions, meet customer needs or re-lend as part of its dealer operations.

The Company receives collateral under reverse repurchase agreements, securities borrowing transactions, derivative transactions, customer margin loans and other secured money-lending activities. In many instances, the Company is also permitted by contract or custom to rehypothecate securities received as collateral. These securities may be used to secure repurchase agreements, enter into securities lending or derivative transactions or cover short positions.

At February 29, 2008 and November 30, 2007, the fair value of securities received as collateral by the Company that can be repledged, delivered or otherwise used was approximately \$303 billion and \$280 billion, respectively. Of these securities received as collateral, those with a fair value of approximately \$211 billion and \$189 billion were delivered, repledged or otherwise used at February 29, 2008 and November 30, 2007, respectively.

The Company also pledges financial instruments owned to collateralize certain financing arrangements and permits the counterparty to pledge or rehypothecate the securities. These securities are recorded as "Financial instruments owned and pledged as collateral, at fair value" in the Condensed Consolidated Statements of Financial Condition. The carrying value of securities and other inventory positions owned that have been pledged or otherwise encumbered to counterparties where those counterparties do not have the right to sell or repledge was approximately \$54 billion and \$65 billion at February 29, 2008 and November 30, 2007, respectively.

#### 7. SHORT-TERM BORROWINGS

The Company obtains unsecured short-term borrowings through the issuance of commercial paper, bank loans, medium term notes and other borrowings. In addition, the Company obtains secured short-term borrowings primarily through master notes and secured bank loans. A master note is an agreement under which a lender may make one or more loans to a borrower, the repayment obligation of which is reflected in a promissory note to the lender. In the case of secured master notes, these agreements are secured by collateral. The interest rates on such short-term borrowings reflect market rates of interest at the time of the transactions.

The Company's short-term borrowings at February 29, 2008 and November 30, 2007 consisted of the following:

(in billions)	February 29, 2008	November 30, 2007
Commercial paper	\$ 3.9	\$ 3.9
Bank loans	1.7	3.1
Medium term notes	0.5	1.9
Other borrowings	2.4	2.7
-----		
Total unsecured short-term borrowings	8.5	11.6
-----		
Secured borrowings	7.8	12.4
-----		
Total short-term borrowings	\$ 16.3	\$ 24.0
=====		

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**Committed Credit Facilities**

As of February 29, 2008, the Company had a committed revolving credit facility ("Facility") totaling \$2.9 billion, which permitted borrowing on a secured basis by the Parent Company, BSSC, BSIL and certain other subsidiaries. The Facility terminated on April 7, 2008. There were no borrowings outstanding under the Facility at February 29, 2008 or on the date of termination.

The Company has a \$1.50 billion committed revolving securities repo facility ("Repo Facility"), which permits borrowings secured by a broad range of collateral under a repurchase arrangement by the Parent Company, BSIL, BSIT and BSB and BS Forex. The Repo Facility contains financial covenants that require, among other things, maintenance of specified levels of stockholders' equity of the Company. The Repo Facility terminates in August 2008, with all repos outstanding at that date payable no later than August 2009. There were no borrowings outstanding under the Repo Facility at February 29, 2008.

The Company has a \$350 million committed revolving credit facility ("Pan Asian Facility"), which permits borrowing on a secured basis by the Parent Company, BSSC, Bear Stearns Japan Limited ("BSJL"), and BSIL. The Pan Asian Facility contains financial covenants that require, among other things, maintenance of specified levels of stockholders' equity of the Company and net capital of BSSC. The Pan Asian Facility terminates in December 2008 with all loans outstanding at that date payable no later than December 2009. There were no borrowings outstanding under the Pan Asian Facility at February 29, 2008.

As of February 29, 2008, the Company had a \$450 million committed revolving credit facility ("Tax Lien Facility"), which permitted borrowing on a secured basis by the Parent Company, Plymouth Park Tax Services and Madison Tax Capital LLC. The Tax Lien Facility terminated in March 2008. There were no borrowings outstanding under the Tax Lien Facility at February 29, 2008 or on the date of termination.

As of February 29, 2008, the Company had a committed revolving credit facility ("AAA Facility") totaling \$750 million, which permits borrowing on an unsecured basis by Bear Stearns Financial Products ("BSFP"). Under the AAA Facility, BSFP may borrow up to the committed amount in the event of: (i) a Bankruptcy Event, as defined, at The Bear Stearns Companies Inc.; (ii) the downgrade of The Bear Stearns Companies Inc.'s short term debt rating to A-2 by S&P or to P-2 by Moody's; (iii) the failure of Bear Stearns Capital Markets to post collateral with or make payments to BSFP in accordance with BSFP's Operating Guidelines; (iv) the failure of BSFP to meet the capital requirements required by its Operating Guidelines; or (v) the downgrade of BSFP's counterparty credit rating below A by S&P or below A2 by Moody's. The AAA Facility terminates on April 25, 2008, with all loans outstanding at that date payable no later than April 2009. There were no borrowings outstanding under the AAA Facility at February 29, 2008.

The Company also maintains a series of committed credit facilities, which permit borrowing on a secured basis, to support liquidity needs for the financing of investment-grade and non-investment-grade corporate loans, residential mortgages, commercial mortgages, listed options and whole loans. The facilities are expected to be drawn from time to time and expire at various dates, the longest of such periods ending in fiscal 2008. All of these facilities contain a term-out option of one year or more for borrowings outstanding at expiration. The banks providing these facilities are committed to provide up to an aggregate of approximately \$6.7 billion. At February 29, 2008, the borrowings outstanding under these committed credit facilities were \$3.3 billion.

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**8. LONG-TERM BORROWINGS**

The Company's long-term borrowings (which have original maturities of at least 12 months) at February 29, 2008 and November 30, 2007 consisted of the following:

(in billions)	February 29, 2008	November 30, 2007
Fixed rate notes due 2008 to 2047	\$ 32.5	\$ 28.7
Floating rate notes due 2008 to 2046	30.3	31.3
Index/equity/credit-linked notes	9.0	8.5
<b>Total long-term borrowings</b>	<b>\$ 71.8</b>	<b>\$ 68.5</b>

The Company's long-term borrowings include fair value adjustments in accordance with SFAS No. 133, hybrid financial instruments accounted for at fair value as elected under SFAS No. 155, as well as \$263 million of junior subordinated deferrable interest debentures ("Debentures"). The Debentures will mature on May 15, 2031; however, effective May 15, 2006, the Company, at its option, may redeem the Debentures. The Debentures are reflected in the table at their contractual maturity dates. During the three months ended February 29, 2008, the Company issued and retired/repurchased \$4.4 billion and \$3.5 billion of long-term borrowings, respectively. The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 4.6 years and 4.3 years at February 29, 2008 and November 30, 2007, respectively.

**9. STOCKHOLDERS' EQUITY - RSU TRUST**

In connection with the Company's deferred compensation plans, during the first quarter of fiscal 2008, the Company established an irrevocable grantor trust (the "RSU Trust") for the purpose of holding shares of common stock of the Company underlying awards granted to selected employees and certain key executives under The Bear Stearns Companies Inc. Capital Accumulation Plan for Senior Managing Directors and The Bear Stearns Companies Inc. Restricted Stock Unit Plan. During the first quarter, the company transferred 27.3 million treasury shares to the RSU Trust. In accordance with EITF Issue No. 97-14, "Accounting for Deferred Compensation Arrangements where Amounts Earned Are Held in a Rabbi Trust and Invested," assets of the RSU Trust are consolidated and both the shares held by the RSU Trust and the related deferred compensation obligation are recorded in equity. Shares issued to the RSU Trust are recorded in "Shares held in RSU trust" and obligations under deferred compensation plans are recorded in "Employee stock compensation plans," both at an amount equal to the original amount of the compensation deferred (fair value of the deferred stock award at the date of grant) in the Condensed Consolidated Statements of Financial Condition. Changes in fair value of amounts owed to employees are not recognized. Shares transferred to the RSU Trust do not affect the total number of shares used in the calculation of basic and diluted earnings per share. Accordingly, the RSU Trust has no effect on total equity, net income, book value per share or earnings per share.

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10. EARNINGS PER SHARE

Basic EPS is computed by dividing net income applicable to common shares, adjusted for costs related to vested shares under the CAP Plan, as well as the effect of the redemption of preferred stock, by the weighted average number of common shares outstanding. Common shares outstanding includes vested units issued under certain stock compensation plans, which will be distributed as shares of common stock. Diluted EPS includes the determinants of basic EPS and, in addition, gives effect to dilutive potential common shares related to stock compensation plans.

The computations of basic and diluted EPS are set forth below:

	Three Months Ended	
(in millions, except per share amounts)	February 29, 2008	February 28, 2007
Net income	\$ 115	\$ 554
Preferred stock dividends	(5)	(6)
Income adjustment (net of tax) applicable to deferred compensation arrangements-vested shares	5	15
Net earnings used for basic EPS	115	563
Income adjustment (net of tax) applicable to deferred compensation arrangements-nonvested shares	4	9
Net earnings used for diluted EPS	\$ 119	\$ 572
=====		
Total basic weighted average common shares outstanding (1)	129	133
Effect of dilutive securities:		
Employee stock options	2	7
CAP and restricted units	8	10
Dilutive potential common shares	10	17
Weighted average number of common shares outstanding and dilutive potential common shares	139	150
=====		
Basic EPS	\$ 0.89	\$ 4.23
Diluted EPS	\$ 0.86	\$ 3.82
=====		

(1) Includes approximately 12 million and 13 million vested units for the three months ended February 29, 2008 and February 28, 2007, respectively, issued under stock compensation plans which will be distributed as shares of common stock.

(2) Options to purchase approximately 8 million shares of common stock at prices ranging from \$87.68 to \$165.32 were outstanding but were not included in the computation of diluted EPS because the exercise price was greater than the average market price of the common stock.

11. REGULATIONS

The Company is regulated by the SEC as a consolidated supervised entity ("CSE"). As a CSE, the Company is subject to group-wide supervision and examination by the SEC and is required to compute allowable capital and allowances for market, credit and operational risk on a consolidated basis. As of February 29, 2008, the Company was in compliance with the CSE capital requirements.

Bear Stearns and BSSC are registered broker-dealers and futures commission merchants and, accordingly, are subject to Rule 15c3-1 under the Exchange Act ("Net Capital Rule") and Rule 1.17 under the Commodity Futures Trading Commission. Bear Stearns uses Appendix E of the Net Capital Rule ("Appendix E"), which establishes alternative net capital requirements for broker-dealers that are part of consolidated supervised entities. Appendix E allows Bear Stearns to calculate net capital charges for market risk and derivatives-related credit risk based on mathematical models provided that Bear Stearns holds tentative net capital in excess of \$1 billion and net capital in excess of \$500 million. At February 29, 2008, Bear Stearns' net capital of \$2.89 billion exceeded the minimum requirement by \$2.34 billion. Bear Stearns' net capital computation, as defined, includes \$545 million, which is net capital of BSSC in excess of 5.5% of aggregate debit items arising from customer transactions.



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BSIL and BSIT, London-based broker-dealer subsidiaries, are subject to the regulatory capital requirements of the United Kingdom's Financial Services Authority.

BSB, an Ireland-based bank principally involved in the trading and sales of fixed income products, is registered in Ireland and is subject to the regulatory capital requirements of the Financial Regulator.

Bear Stearns Bank & Trust Company ("BSBTC") (formerly known as Custodial Trust Company), a Federal Deposit Insurance Corporation ("FDIC") insured New Jersey state chartered bank, offers a range of trust, lending, deposit, and securities-clearing products and services. BSBTC provides the Company with banking powers, including access to the securities and funds-wire services of the Federal Reserve System. BSBTC is subject to the regulatory capital requirements of the FDIC.

At February 29, 2008, Bear Stearns, BSSC, BSIL, BSIT, BSB and BSBTC were in compliance with their respective regulatory capital requirements. Certain other subsidiaries are subject to various securities regulations and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. At February 29, 2008, these other subsidiaries were in compliance with their applicable local capital adequacy requirements.

**12. COMMITMENTS AND CONTINGENCIES**

In the ordinary course of business, the Company has commitments in connection with various activities, the most significant of which are as follows:

**Leases**

The Company occupies office space under leases that expire at various dates through 2024. At February 29, 2008, future minimum aggregate annual rentals payable under non-cancelable leases (net of subleases), including 383 Madison Avenue in New York City, for fiscal years ended 2008 through 2012 and the aggregate amount thereafter, are as follows:

(in millions)

<b>FISCAL YEAR</b>		
2008 (remaining)	\$	91
2009		117
2010		118
2011		128
2012		95
Thereafter		640
-----		
Total	\$	1,189
=====		

**Lending - Related Commitments**

In connection with certain of the Company's business activities, the Company provides financing or financing commitments to investment-grade and non-investment-grade companies in the form of senior and subordinated debt, including bridge financing. Commitments have varying maturity dates and are generally contingent on the accuracy and validity of certain representations, warranties and contractual conditions applicable to the borrower. Lending-related commitments to investment-grade borrowers aggregated approximately \$2.59 billion and \$3.42 billion at February 29, 2008 and November 30, 2007, respectively. Of these amounts, approximately \$841 million and \$952 million of the credit risk was offset at February 29, 2008 and November 30, 2007, respectively. Lending-related commitments to non-investment-grade borrowers approximated \$2.77 billion and \$3.30 billion at February 29, 2008 and November 30, 2007, respectively. Of these amounts, approximately \$267 million and \$220 million of the credit risk was offset at February 29, 2008 and November 30, 2007, respectively.

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The Company also had contingent commitments to non-investment-grade companies of approximately \$110 million and \$501 million as of February 29, 2008 and November 30, 2007, respectively. Generally, these commitments are provided in connection with leveraged acquisitions. These commitments are not indicative of the Company's actual risk because the borrower may not be successful in the acquisition, the borrower may access the capital markets instead of drawing on the commitment, or the Company's portion of the commitment may be reduced through the syndication process. Additionally, the borrower's ability to draw may be subject to there being no material adverse change in either market conditions or the borrower's financial condition, among other factors. These commitments generally contain certain flexible pricing features to adjust for changing market conditions prior to closing.

**Private Equity-Related Investments and Partnerships**

In connection with the Company's merchant banking activities, the Company has commitments to invest in merchant banking and private equity-related investment funds as well as commitments to invest directly in private equity-related investments. At February 29, 2008 and November 30, 2007, such commitments aggregated \$667 million and \$729 million, respectively. These commitments will be funded, if called, through the end of the respective investment periods, with the longest of such periods ending in 2020.

**Underwriting**

In connection with the Company's mortgage-backed securitizations and fixed income and equity underwriting, the Company had commitments to purchase new issues of securities aggregating \$248 million and \$652 million, respectively, at February 29, 2008 and November 30, 2007.

**Commercial and Residential Loans**

The Company participates in the origination, acquisition, securitization, servicing, financing and disposition of commercial and residential loans. At February 29, 2008 and November 30, 2007, the Company had entered into commitments to purchase or finance mortgage loans of \$1.33 billion and \$2.83 billion, respectively.

**Letters of Credit**

At February 29, 2008 and November 30, 2007, the Company was contingently liable for unsecured letters of credit of approximately \$1.71 billion and \$1.42 billion, respectively, and secured (by financial instruments) letters of credit of \$1.55 billion and \$1.33 billion, respectively. These letters of credit are primarily used to provide collateral for securities borrowed and to satisfy margin requirements at commodity/futures exchanges.

**Energy**

In connection with its energy activities, the Company has entered into contractual obligations (primarily obligations under tolling agreements, net of re-tolling agreements) that require future cash payments. At February 29, 2008 those contractual obligations, by maturity, were as follows:

(in millions)

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<b>FISCAL YEAR</b>	
2008 (remaining)	\$ 65
2009	91
2010	90
2011	260
2012	417
Thereafter	3,403
-----	
Total	\$ 4,326
=====	

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**Other**

The Company had commitments to purchase Chapter 13 and other credit card receivables of \$189 million and \$170 million, respectively, at February 29, 2008 and November 30, 2007.

With respect to certain of the commitments outlined above, the Company utilizes various hedging strategies to actively manage its market, credit and liquidity exposures. Additionally, since these commitments may expire unused, the total commitment amount may not necessarily reflect the actual future cash funding requirements.

**Litigation**

The Company is the sole defendant in an action commenced in the United States Bankruptcy court for the Southern District of New York by the Chapter 11 Trustee for Manhattan Investment Fund Limited ("MIFL"). The complaint seeks to recover from the Company, among other things, certain allegedly fraudulent transfers made by MIFL in the amount of \$141 million plus pre-judgment interest. The Company provided prime brokerage services to MIFL prior to its bankruptcy. In January 2007, the Bankruptcy Court granted the Trustee's motion for summary judgment on the fraudulent transfer claims against the Company.

On appeal, the District Court affirmed the Bankruptcy Court's findings in part, but also reversed in part, the Bankruptcy's Court's grant of summary judgment to the Trustee, finding that a trial is necessary to make a factual finding as to whether the Company acted in good faith with respect to its receipt of the alleged fraudulent transfers. The Company believes it has substantial defenses to the Trustee's claims.

The Company and certain subsidiaries have been named as defendants in various investor lawsuits and FINRA arbitrations relating to the failure of the Bear Stearns High Grade Structured Credit Strategies Master Fund, Ltd (the "High Grade Fund") and the Enhanced Leverage Master Fund, Ltd. (the "Enhanced Leverage Fund"), which were managed by Bear Stearns Asset Management. Also, the Company and certain subsidiaries have been named as defendants in a lawsuit by the Joint Voluntary Liquidators of the overseas "feeder funds" of the High Grade Fund and Enhanced Leverage Fund. The High Grade Fund had net investor contributions of approximately \$775 million. The Enhanced Fund had net investor contributions of approximately \$1.08 billion. The relief being sought by the plaintiffs in these matters includes specified and unspecified damages, costs and fees. The Company believes it has substantial defenses to the claims asserted against it in these proceedings. Additionally, the Company and its subsidiaries have been the subject of various state and federal regulatory and law enforcement inquiries, and a state administrative proceeding relating to the Funds.

In the normal course of business, the Company has been named as a defendant in various legal actions, including arbitrations, class actions and other litigation. Certain of the legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. The Company is also involved in other reviews, investigations and proceedings by governmental and self-regulatory agencies regarding the Company's business, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. Because litigation is inherently unpredictable, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss related to such matters, how such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief might be. Consequently, the Company cannot estimate losses or ranges of losses for matters where there is only a reasonable possibility that a loss may have been incurred. Although the ultimate outcome of these matters cannot be ascertained at this time, it is the opinion of management, after consultation with counsel, that the resolution of the foregoing matters will not have a material adverse effect on the financial condition of the Company, taken as a whole; such resolution may, however, have a material effect on the operating results in any future period, depending on the level of income for such period. See also Note 17, "Subsequent Events," of the Notes to Condensed Consolidated Financial Statements.

The Company has provided reserves for such matters in accordance with SFAS No. 5, "Accounting for Contingencies." The ultimate resolution may differ materially from the amounts reserved.

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13. INCOME TAXES

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition

The Company adopted FIN No. 48 effective December 1, 2007 and recognized a decrease to beginning retained earnings of approximately \$90.7 million.

The gross amount of unrecognized tax benefits ("UTB") as of the date of adoption of FIN No. 48 was approximately \$578.4 million. Of this total, approximately \$371.4 million (net of federal benefit of state issues, Competent Authority and foreign tax credit offsets) represents the amount that, if recognized, would favorably affect the effective tax rate in future periods.

The Company recognizes the accrual of interest and penalties, if any, to UTB's in income tax expense. Interest accrued on UTB's as of December 1, 2007 was approximately \$108.9 million.

The Company is under examination by the Internal Revenue Service ("IRS") and other tax authorities. The other major exams include Japan, the United Kingdom, and locations in which it has significant business operations, such as New York State and City. The tax years under examination vary by jurisdiction as follows:

Jurisdiction	Open Tax Years Examination in progress	Open Tax Years Examination not yet initiated
United States	2003-2005	2006-2007
United Kingdom	1999-2005	2006-2007
Japan	2000-2003	2004-2007
New York State	1999-2002	2003-2007
New York City	1997-2000	2001-2007

It is reasonably possible that these tax examinations will be completed within the next 12 months. Based on the status of these examinations and the protocol of finalizing audits by the relevant tax authorities, which could include formal appeal and/or legal proceedings, it is not possible to estimate the impact of any amount of such changes, if any, to previously recorded uncertain tax positions.

The tax benefit associated with employee stock plans reduced taxes payable by \$254 million, \$363 million and \$426 million for 2007, 2006 and 2005, respectively. These benefits have been reflected as additional paid-in-capital in the accompanying Condensed Consolidated Statements of Financial Condition, except for certain 2007, 2006 and 2005 stock awards. On December 1, 2005, the Company adopted SFAS No. 123 (R). Under SFAS No.

123 (R) all share-based compensation is required to be recognized as an expense in the year of grant with a corresponding tax benefit recorded to the tax provision. See Note 17, "Subsequent Events," in the Notes to Condensed Consolidated Financial Statements for a discussion of the impact the merger agreement between the Company and JPMorgan Chase will have on the realization of the deferred tax asset recorded in prior years.

14. GUARANTEES

In the ordinary course of business, the Company issues various guarantees to counterparties in connection with certain derivative, leasing, securitization and other transactions. FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," requires the Company to recognize a liability at the inception of certain guarantees and to disclose information about its obligations under certain guarantee arrangements.

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The guarantees covered by FIN No. 45 include contracts that contingently require the guarantor to make payments to the guaranteed party based on changes related to an asset, a liability or an equity security of the guaranteed party, contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an agreement and indirect guarantees of the indebtedness of others, even though the payment to the guaranteed party may not be based on changes to an asset, liability or equity security of the guaranteed party. In addition, FIN No. 45 covers certain indemnification agreements that contingently require the guarantor to make payments to the indemnified party, such as an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law.

The following table sets forth the maximum payout/notional amounts associated with the Company's guarantees as of February 29, 2008:

(in millions)	Amount of Guarantee Expiration Per Period				Total
	Less Than One Year	One to Three Years	Three to Five Years	Greater than Five Years	
Certain derivative contracts (notional)(1)	\$ 537,763	\$ 515,993	\$ 859,651	\$ 742,403	\$ 2,655,810
Municipal securities	3,131	58	-	-	3,189
Residual value guarantee	-	-	570	-	570

(1) The gross carrying value of these derivatives approximated \$130.9 billion as of February 29, 2008.

### Derivative Contracts

The Company's dealer activities cause it to make markets and trade a variety of derivative instruments. Certain derivative contracts that the Company has entered into meet the accounting definition of a guarantee under FIN No. 45. Derivatives that meet the FIN No. 45 definition of guarantees include credit default swaps (whereby a default or significant change in the credit quality of the underlying financial instrument may obligate the Company to make a payment), put options, as well as floors, caps and collars. Since the Company does not track the counterparties' purpose for entering into a derivative contract, it has disclosed derivative contracts that are likely to be used to protect against a change in an underlying financial instrument, regardless of their actual use.

On certain of these contracts, such as written interest rate caps and foreign currency options, the maximum payout cannot be quantified since the increase in interest rates and foreign exchange rates is not contractually limited by the terms of the contracts. As such, the Company has disclosed notional amounts as a measure of the extent of its involvement in these classes of derivatives rather than maximum payout. Notional amounts do not represent the maximum payout and generally overstate the Company's exposure to these contracts.

In connection with these activities, the Company mitigates its exposure to market risk by entering into a variety of offsetting derivative contracts and security positions.

### Municipal Securities

In 1997, the Company established a program whereby it created a series of municipal securities trusts in which it has retained interests. These trusts purchase fixed-rate, long-term, highly rated, insured or escrowed municipal bonds financed by the issuance of trust certificates. Certain of the trust certificates entitle the holder to receive future payments of principal and variable interest and to tender such certificates at the option of the holder on a periodic basis. The Company acts as placement agent and as liquidity provider. The purpose of the program is to allow the Company's clients to purchase synthetic short-term, floating-rate municipal debt that does not otherwise exist in the marketplace. In the Company's capacity as liquidity provider to the trusts, the maximum exposure to loss at February 29, 2008 was approximately \$3.2 billion, which represents the outstanding amount of all trust certificates. This exposure to loss is mitigated by the underlying municipal bonds held by trusts. The underlying municipal bonds in the trusts are either AAA or AA rated, insured or escrowed to maturity. Such bonds had a market value, net of related offsetting positions, approximating \$2.9 billion at February 29, 2008. See Note 17, "Subsequent Events," of the Notes to Condensed Consolidated Financial Statements for a further discussion.

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**Residual Value Guarantee**

The Company has entered into an operating lease arrangement for its world headquarters at 383 Madison Avenue in New York City (the "Synthetic Lease"). Under the terms of the Synthetic Lease, the Company is obligated to make monthly payments based on the lessor's underlying interest costs. The Synthetic Lease expires on August 10, 2012 unless both parties agree to a renewal prior to expiration. At the expiration date of the Synthetic Lease, the Company has the right to purchase the building for the amount of the then outstanding indebtedness of the lessor or to arrange for the sale of the property with the proceeds of the sale to be used to satisfy the lessor's debt obligation. If the sale of the property does not generate sufficient proceeds to satisfy the lessor's debt obligation, the Company is required to fund the shortfall up to a maximum residual value guarantee. As of February 29, 2008, there was no expected shortfall and the maximum residual value guarantee was approximately \$570 million.

**Indemnifications**

The Company provides representations and warranties to counterparties in connection with a variety of commercial transactions, including certain asset sales and securitizations and occasionally indemnifies them against potential losses caused by the breach of those representations and warranties. To mitigate these risks with respect to assets being securitized that have been originated by third parties, the Company seeks to obtain appropriate representations and warranties from such third-party originators upon acquisition of such assets. The Company generally performs due diligence on assets purchased and maintains underwriting standards for assets originated. The Company may also provide indemnifications to certain counterparties to protect them in the event additional taxes are owed or payments are withheld, due either to a change in or adverse application of certain tax laws. These indemnifications generally are standard contractual terms and are entered into in the normal course of business. Generally, there are no stated or notional amounts included in these indemnifications.

Maximum payout information under these indemnifications is not readily available because of the number, size and lives of these transactions. In implementing this accounting interpretation, the Company reviewed its experience with the indemnifications on these structures. Based on such experience, it is unlikely that these arrangements will have a material impact on the Condensed Consolidated Financial Statements of the Company.

**Other Guarantees**

The Company is a member of numerous exchanges and clearinghouses. Under the membership agreements, members are generally required to guarantee the performance of other members. Therefore, if a member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet these shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. The Company's maximum potential liability under these arrangements cannot be quantified. However, the potential for the Company to be required to make payments under these arrangements is remote. Accordingly, no contingent liability is recorded in the Condensed Consolidated Financial Statements for these arrangements.

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15. SEGMENT DATA

The Company operates in three principal segments -- Capital Markets, Global Clearing Services and Wealth Management. These segments offer different products and services and are managed separately as different levels and types of expertise are required to effectively manage the segments' transactions.

The Capital Markets segment is comprised of the institutional equities, fixed income and investment banking areas. The Capital Markets segment operates as a single integrated unit that provides the sales, trading and origination effort for various fixed income, equity and advisory products and services. Each of the three businesses work in tandem to deliver these services to institutional and corporate clients.

Institutional equities consists of sales, trading and research, in areas such as domestic and international equities, block trading, over-the-counter equities, equity derivatives, energy and commodity activities, risk and convertible arbitrage and specialist activities on the New York Stock Exchange, American Stock Exchange and International Securities Exchange. Fixed income includes sales, trading, origination and research provided to institutional clients across a variety of products such as mortgage- and asset-backed securities, corporate and government bonds, municipal bonds, high yield products, including bank and bridge loans, foreign exchange and interest rate and credit derivatives. Investment banking provides services in capital raising, strategic advice, mergers and acquisitions and merchant banking. Capital raising encompasses the Company's underwriting of equity, investment grade, municipal and high yield debt products.

The Global Clearing Services segment provides execution, clearing, margin lending and securities borrowing to facilitate customer short sales to clearing clients worldwide. Prime brokerage clients include hedge funds and clients of money managers, short sellers and other professional investors. Fully disclosed clients engage in either the retail or institutional brokerage business.

The Wealth Management segment is composed of the PCS and asset management areas. PCS provides high-net-worth individuals with an institutional level of investment service, including access to the Company's resources and professionals. Asset management manages equity, fixed income and alternative assets for leading corporate pension plans, public systems, endowments, foundations, multi-employer plans, insurance companies, corporations, families and high-net-worth individuals in the United States and abroad.

The three business segments comprise many business areas, with interactions among each. Revenues and expenses include those that are directly related to each segment. Revenues from intersegment transactions are based upon specific criteria or agreed upon rates with such amounts eliminated in consolidation. Individual segments also include revenues and expenses relating to various items, including corporate overhead and interest, which are internally allocated by the Company primarily based on balance sheet usage or expense levels. The Company generally evaluates performance of the segments based on net revenues and profit or loss before provision for income taxes.

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(in millions)	Three Months ended	
	February 29, 2008	February 28, 2007
<b>NET REVENUES</b>		
Capital Markets		
Institutional Equities	\$ 811	\$ 513
Fixed Income	66	1,149
Investment Banking	159	303
Total Capital Markets	1,036	1,965
Global Clearing Services	253	276
Wealth Management		
Private Client Services (1)	161	136
Asset Management	39	119
Total Wealth Management	200	255
Other (2)	(10)	(14)
Total net revenues	\$ 1,479	\$ 2,482
<b>PRE-TAX INCOME</b>		
Capital Markets		
Global Clearing Services	\$ 171	\$ 736
Wealth Management	86	113
Other (3)	(42)	44
Total pre-tax income	\$ 153	\$ 835

	Three Months ended	
	February 29, 2008	February 28, 2007
(1) Private Client Services detail:		
Gross revenues, before transfer to Capital Markets segment	\$ 183	\$ 166
Revenue transferred to Capital Markets segment	(22)	(30)
Private Client Services net revenues	\$ 161	\$ 136

(2) Includes consolidation and elimination entries.

(3) Includes certain legal costs and costs related to the CAP Plan.

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	As of	
(in billions)	February 29, 2008	February 28, 2007
-----		
SEGMENT ASSETS		
Capital Markets	\$ 244	\$ 278
Global Clearing Services	124	101
Wealth Management	4	4
Other	27	12
-----		
Total segment assets	\$ 399	\$ 395
=====		

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16. ASSET ACQUISITION

In connection with the acquisition of substantially all of the power-related and natural gas assets comprising the power trading business of Williams Power Company, Inc., an energy trading and marketing subsidiary of The Williams Companies, Inc., which closed on November 8, 2007, the Company recorded intangible assets and intangible liabilities based on contractual arrangements, at their estimated fair values. As of February 29, 2008, the weighted average amortization period for intangible assets and intangible liabilities was approximately 10.6 years and 13.3 years, respectively. The results of operations of the power-related assets and liabilities acquired are included in the Company's Capital Markets segment.

The estimated aggregate amortization expense for each of the five succeeding fiscal years for intangible assets and intangible liabilities were as follows:

(in millions)	Intangible Assets	Intangible Liabilities
FISCAL YEAR		
2008 (remaining)	\$ 83	\$ 171
2009	98	129
2010	96	98
2011	64	74
2012	50	47
Thereafter	456	359
Total	\$ 847	\$ 878

17. SUBSEQUENT EVENTS

BACKGROUND OF THE MERGER

The Company experienced a significant liquidity crisis during the end of the week of March 10, 2008 that seriously jeopardized its financial viability and which raises substantial doubt about its ability to continue as a going concern. As a result, on March 16, 2008, the Company and JPMorgan Chase & Co. ("JPMorgan Chase") entered into an agreement and plan of merger, and on March 24, 2008, entered into an amendment to the agreement and plan of merger (as amended, the "Merger Agreement"). Pursuant to the Merger Agreement, each share of the Company's common stock outstanding immediately prior to the merger will be exchanged for 0.21753 shares of JPMorgan Chase common stock. A summary of the Merger Agreement, related transaction documents and the accounting implications are described in more detail in the Transaction Documents and Accounting Implications sections of this note.

In connection with the entry into the amendment to the Merger Agreement, the Company and JPMorgan Chase entered into a share exchange agreement under which JPMorgan Chase will purchase 95 million newly issued shares of the Company's common stock, or 39.5% of the outstanding common stock of the Company after giving effect to the issuance, in exchange for the issuance of 20,665,350 shares of JPMorgan Chase common stock to the Company and the entry by JPMorgan Chase into the amendment to the merger agreement, an amended and restated guaranty agreement and the guaranty agreement with the Federal Reserve Bank of New York ("New York Fed"). The share exchange was completed on April 8, 2008.

Concurrent with the closing of the merger, the New York Fed will take, through a limited liability company formed for this purpose, control of a portfolio of \$30 billion in assets of the Company based on the value of the portfolio as of March 14, 2008. The assets will be funded by a \$29 billion, 10-year term note from the New York Fed, and a \$1

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billion, 10-year subordinated note from JPMorgan Chase. The JPMorgan Chase note is subordinated to the New York Fed loan and will bear the first \$1 billion of any losses associated with the assets. Any funds remaining after payment of the New York Fed loan, the JPMorgan Chase note and other expenses of the limited liability company, will be paid to the New York Fed.

**TRANSACTION DOCUMENTS**

**Agreement and Plan of Merger**

Upon the terms and subject to the conditions set forth in the Merger Agreement, a wholly-owned subsidiary of JPMorgan Chase will merge with and into the Company with the Company continuing as the surviving corporation and as a wholly-owned subsidiary of JPMorgan Chase (the "Merger"). At the effective time of the Merger, each share of Company common stock will be converted into the right to receive 0.21753 of a share of JPMorgan Chase common stock. Outstanding Company stock options and phantom stock units will be converted into JPMorgan Chase equity awards, adjusted to reflect the exchange ratio in the Merger. The Company and JPMorgan Chase have agreed to consider providing holders of restricted stock units and capital accumulation plan units with the right to elect, prior to completion of the Merger, to have outstanding awards distributed in cash (rather than stock) at the same time the units would have been settled absent such election, and otherwise subject to the same terms and conditions in the applicable plans and award agreements, as amended.

The Merger Agreement contains representations and warranties of Bear Stearns and JPMorgan Chase relating to their respective businesses. Pursuant to the Merger Agreement, the Company has agreed to operate within its existing credit, principal, market and other risk limits and comply with existing risk-related policies and procedures, subject to JPMorgan Chase's right to oversee the Company's setting and changing of such policies, procedures and limits. Subject to the continued effectiveness of the Guaranty (as defined below), the Company has granted JPMorgan Chase the right to oversee the business, operations and management of the Company in its reasonable discretion. The Company also granted JPMorgan Chase the rights to custody of, and to manage, a scheduled collateral pool and related hedges, which rights were delegated to the New York Fed. Additionally, the Company has agreed not to (i) solicit proposals relating to alternative business combination transactions or (ii) subject to certain exceptions, enter into discussions, or enter into any agreement, concerning, or provide confidential information in connection with, any proposals for alternative business combination transactions.

Consummation of the Merger is subject to the satisfaction of certain conditions including, among other things, (i) approval and adoption of the Merger Agreement by the Company's stockholders; (ii) registration and NYSE listing of the common stock to be issued by JPMorgan Chase in the Merger; (iii) absence of any order, injunction or decree preventing or making illegal the consummation of the Merger; and (iv) receipt of specified governmental and regulatory approvals.

The Merger Agreement contains certain termination rights for both the Company and JPMorgan Chase. In the event the Company's stockholders do not approve and adopt the Merger Agreement at the first stockholders meeting called for that purpose, JPMorgan Chase will have the right to exercise an option to purchase the Company's headquarters building for an amount equal to \$1.1 billion less assumed indebtedness and transfer costs. In addition, JPMorgan Chase will also have the right to exercise such option following the termination of the Merger Agreement under the following circumstances:

(i) JPMorgan Chase terminates the Merger Agreement because (A) the Company's board of directors made any change of recommendation, (B) the Company breached its no-solicitation and related obligations under the Merger Agreement, or (C) the Company breached its obligations to hold a meeting of its stockholders to approve and adopt the Merger Agreement, or

(ii) (A) JPMorgan Chase or the Company terminate the Merger Agreement because both (x) the approval and adoption of the Merger Agreement by the Company's stockholders has not been obtained and (y) 120 days have elapsed from the date of such stockholders meeting (provided that the parties may mutually agree to extend the 120-day period); (B) JPMorgan Chase terminates the Merger Agreement because there has been an uncured breach by the Company of any of the covenants or agreements or any of the representations or warranties in the Merger Agreement that would cause the failure of the closing conditions set forth in the Merger Agreement to be satisfied; or (C) JPMorgan Chase or the Company terminates the Merger Agreement because the merger has not been consummated on or before the first anniversary of the date of the Merger Agreement, and prior to any termination of the merger agreement described in this clause (ii) an alternative proposal has been publicly announced or otherwise communicated or made known to the

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Company and has not been irrevocably withdrawn. Upon the exercise of the option to purchase the Company's headquarters building, the Company will, upon the request of JPMorgan Chase, exercise its option to purchase the headquarters building and take all action required to acquire the building and simultaneously convey it to JPMorgan Chase.

The foregoing description of the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which is filed as Exhibit 2.1 to the Company's Current Report on Form 8-K filed on March 20, 2008 and March 24, 2008 (Amendment No. 1).

Beginning March 17, 2008, various stockholders of the Company filed several purported class action lawsuits against the Company, its board of directors and certain of the Company's present and former executive officers. Among other things, these actions allege that the individual defendants breached their fiduciary duties and obligations to the Company's stockholders by agreeing to the proposed merger. Five of these actions have been filed in the Supreme Court of the State of New York and consolidated under the caption In re Bear Stearns Litigation. Two actions have been filed in the Delaware Court of Chancery where plaintiffs have filed a motion to consolidate their cases in Delaware. JPMorgan Chase is named as a defendant in certain of these cases. In each of these actions, plaintiffs seek to enjoin the proposed merger and enjoin JPMorgan Chase from voting the 95 million shares acquired pursuant to the Share Exchange Agreement (as defined below), other injunctive relief and an unspecified amount of compensatory damages. On April 9, 2008, the Delaware Chancery Court granted JPMorgan Chase's and the Company's motion to stay the Delaware action in favor of the New York action, at least until the preliminary injunction motion is resolved. The Delaware court also granted plaintiffs' motion to consolidate their cases. Additionally, on April 10, 2008, an amended complaint was filed in a previously-filed shareholder derivative suit naming the Company's directors and certain former and present executive officers. This amended complaint seeks, among other things, a declaration that the Merger Agreement is unlawful, unenforceable, and seeks to enjoin the merger.

#### **Share Exchange Agreement**

On March 24, 2008, the Company and JPMorgan Chase, in connection with entering into the amendment to the Merger Agreement, entered into a share exchange agreement (the "Share Exchange Agreement"), under which JPMorgan Chase will purchase 95 million newly issued shares of the Company's common stock, or 39.5% of the outstanding shares of the Company's common stock after giving effect to the issuance, in exchange for the issuance of 20,665,350 shares of JPMorgan Chase common stock to the Company and the entry by JPMorgan Chase into the amendment to the merger agreement, an amended and restated guaranty agreement and the guaranty in favor of the New York Fed (each as described below). The share exchange was completed on April 8, 2008.

The foregoing description of the Share Exchange Agreement does not purport to be complete and is qualified in its entirety by reference to the Share Exchange Agreement, which is filed as Exhibit 2.2 to the Company's Current Report on Form 8-K filed on March 24, 2008.

#### **Amended and Restated Guaranty Agreement**

On March 24, 2008, JPMorgan Chase, in connection with the amendment to the Merger Agreement, entered into an amended and restated guaranty agreement (the "Guaranty"), effective retroactively from March 16, 2008, which replaces the guaranty agreement entered into on March 16, 2008 in connection with the Merger Agreement. Pursuant to the Guaranty, JPMorgan Chase will guarantee certain liabilities of the Company and certain of its operating subsidiaries (the "Guaranteed Bear Entities") to the extent such liabilities arise prior to the end of the specified "Guaranty Period", including (i) liabilities and obligations under revolving credit facilities, letters of credit and letter of credit facilities, term loan facilities, lines of credit or uncommitted loan facilities, in each case whether secured or unsecured, of the Guaranteed Bear Entities, (ii) brokerage and trading contract obligations of the Guaranteed Bear Entities (including liabilities and obligations arising under prime brokerage agreements and accounts, securities lending agreements, custodial and carrying agreements, securities accounts and securities contracts, commodity contracts, forward contracts, futures contracts, tolling agreements, energy management agreements, repurchase or reverse repurchase agreements, swap agreements, foreign exchange and currency contracts, options or other derivatives, settlement or clearing agreements and arrangements, margin loan agreements, other contracts or transactions similar to any of the foregoing, any customary brokerage commission with respect to

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the foregoing, any contractual obligation to provide collateral or margin in respect of any of the foregoing or any obligation under a guaranty of any of the foregoing and (iii) obligations of the Guaranteed Bear Entities to deliver cash, securities or other property to customers pursuant to customary custody arrangements. The Guaranty Period will end (subject to provision of further notice by JPMorgan Chase posted on its website at least three days prior to the end of the Guaranty Period), no sooner than the earliest to occur of (i) the date that is 120 days following the failure of the Company's stockholders to approve and adopt the Merger Agreement at a meeting of the Company's stockholders convened for that purpose, (ii) the date that is 120 days following closing of the Merger and (iii) the date of termination of the Merger Agreement.

The foregoing description of the Guaranty does not purport to be complete and is qualified in its entirety by reference to the Guaranty, which is filed as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on March 24, 2008.

**Guarantee and Collateral Agreement**

On March 24, 2008, JPMorgan Chase, in connection with the amendment to the Merger Agreement and the Guaranty, entered into a guarantee and collateral agreement (the "Guarantee and Collateral Agreement") with the Company and certain of its subsidiaries (collectively, the "Collateral Parties") pursuant to which the Collateral Parties agreed to guarantee the obligations of each of them to repay to JPMorgan Chase (1) any loans or other advances of credit by JPMorgan Chase and its affiliates to the Company and its affiliates and (2) any amounts paid by JPMorgan Chase to creditors of the Company and its affiliates under the Guaranty and the Fed Guarantee (as defined below). Each of the Collateral Parties secured their guarantee by granting a lien on substantially all of their respective assets, subject to certain carve-outs.

The foregoing description of the Guarantee and Collateral Agreement does not purport to be complete and is qualified in its entirety by reference to the Guarantee and Collateral Agreement, which is filed as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on March 28, 2008.

**Fed Guaranty Agreement**

On March 24, 2008, JPMorgan Chase, in connection with the amendment to the Merger Agreement, entered into a guarantee in favor of the New York Fed (the "Fed Guarantee"), pursuant to which JPMorgan Chase guaranteed certain obligations of the Company and certain of its affiliates to the New York Fed. Such guarantee will apply with respect to transactions entered into prior to the termination of the Merger Agreement and may be terminated by JPMorgan Chase with respect to transactions thereafter.

The foregoing description of the Fed Guaranty does not purport to be complete and is qualified in its entirety by reference to the Fed Guarantee, which is filed as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on March 24, 2008.

**ACCOUNTING IMPLICATIONS**

Based on the activities discussed above, the following accounting impacts on the Condensed Consolidated Financial Statements have occurred or are expected to occur for periods ending after March 10, 2008:

**Municipal Securities**

The Company acts as placement agent and as liquidity provider under a municipal tender option bond program as described in Note 14, "Guarantees" in Notes to the Condensed Consolidated Financial Statements of the Company. Under the program, the Company has created a series of municipal securities trusts which purchase fixed-rate, long-term, highly rated, insured or escrowed municipal bonds financed by the issuance of trust certificates. The trust certificates entitle the holder to tender such certificates at the option of the holder on a periodic basis. Subsequent to March 10, 2008, holders of all the Class A trust certificates had tendered such certificates to the Company, resulting in the Company owning 100% of the trusts and consolidation of the trusts. As a result, the Company recognized losses of approximately \$200 million in the second quarter of 2008.

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**Deferred Tax Asset**

As of February 29, 2008, the Company had approximately \$1.5 billion in net deferred tax assets (approximately \$1.3 billion was associated with its stock-based compensation plans). In accordance with SFAS No. 109, the gross deferred tax assets of \$1.7 billion will be evaluated for future realization and be reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Management will be required to make certain estimates and assumptions in order to assess the realizability of the deferred tax assets. Further full realization of the deferred tax asset for stock-based compensation requires the shares for RSUs and CAP units to be distributed at a price equaling or exceeding the fair value at the grant date. The provisions of SFAS No. 123 (R), however, do not allow a valuation allowance to be recorded based on the current fair value of the Company's shares. Accordingly, given the activities discussed above, the Company believes it is likely that a significant portion of this deferred tax asset will not be realized in the future.

**Goodwill and Intangibles**

As of February 29, 2008, the Company had goodwill and intangible assets. Based on the proposed merger agreement, the Company believes an impairment loss for the \$88 million is probable, and would be recorded in the second quarter of 2008.

Since the liquidity crisis and the announcement of the merger, the Company has experienced substantial deterioration of its earnings capacity. The closing of the merger is expected to occur by June 30, 2008. The Company believes that the termination of the JPMorgan Chase guaranties prior to consummation of the merger or the parties' failure to consummate the merger could seriously jeopardize the Company's financial viability. In addition, absent the Guaranty, the Company could face the increased risk of rapid loss of customers and counterparties. The lack of liquidity and the loss of customers and counterparties would materially adversely affect the Company's financial stability and its viability as a going concern. Accordingly, the Company could be forced to file for bankruptcy protection and need to liquidate. The accompanying Condensed Consolidated Financial Statements do not reflect any adjustments that might result if the Company were unable to continue as a going concern.

## EXHIBIT 99.5

### CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in JPMorgan Chase & Co.'s Registration Statement No. 333-146731 on Form S-3 (the "Registration Statement") of our report dated January 28, 2008 (April 11, 2008 as to Note 23), relating to the consolidated financial statements of The Bear Stearns Companies Inc. (the "Company") as of November 30, 2007 and 2006, and for each of the three years in the period ended November 30, 2007 and our report dated January 28, 2008 (April 11, 2008 as to Note 4), relating to the financial statement schedule of the Company as of November 30, 2007 and 2006, and for each of the three years in the period ended November 30, 2007 (which reports express an unqualified opinion and include explanatory paragraphs referring to (1) substantial doubt about the Company's ability to continue as a going concern, and (2) the adoption of Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140 and Statement of Financial Accounting Standards No. 157, Fair Value Measurements), both appearing as exhibits to JPMorgan Chase & Co.'s Current Report on Form 8-K filed on or about April 16, 2008. We also consent to the reference to us under the heading "Experts" in the prospectus, which is part of the Registration Statement.

*/s/ Deloitte & Touche LLP  
New York, New York  
April 15, 2008*

**Exhibit 99.6**

Letter Re: Unaudited Interim Financial Information

April 15, 2008

JPMorgan Chase & Co.  
270 Park Avenue  
New York, NY 10017-2070

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited condensed consolidated interim financial information of The Bear Stearns Companies Inc. and subsidiaries (the "Company") for the three-month periods ended February 29, 2008 and February 28, 2007, and have issued our report dated April 14, 2008 (which report included explanatory paragraphs referring to substantial doubt about the Company's ability to continue as a going concern, and the adoption of Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109). As indicated in such report, because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, appearing as Exhibit No. 99.4 to JPMorgan Chase & Co.'s Current Report on Form 8-K filed on or about April 16, 2008, is being incorporated by reference in JPMorgan Chase & Co.'s Registration Statement No. 333-146731 on Form S-3.

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

*/s/ Deloitte & Touche LLP  
New York, New York*