



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SCOTT G. ALVAREZ
GENERAL COUNSEL

November 19, 2007

Oliver I. Ireland, Esq.
Morrison & Foerster LLP
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006

Dear Mr. Ireland:

This responds to your letter, dated October 24, 2007, requesting a determination that the formation of an employee stock ownership plan by The Bear Stearns Companies Inc. (“Bear Stearns”), New York, New York, as described below, would not cause Bear Stearns to lose certain grandfather rights under section 4(f) of the Bank Holding Company Act (“BHC Act”) related to its ownership of Custodial Trust Company (“CTC”), Princeton, New Jersey.¹

CTC is a state nonmember bank that became a “bank” for purposes of the BHC Act as a result of the Competitive Equality Banking Act of 1987 (“CEBA”). Bear Stearns currently is the sole shareholder of CTC and would remain the sole shareholder of CTC after consummation of the proposed transactions. Accordingly, Bear Stearns may retain its ownership of CTC and not be treated as a bank holding company only if Bear Stearns and CTC abide by the conditions set forth in section 4(f) of the BHC Act.² In addition, as the legislative history of CEBA makes clear, the grandfather rights granted by section 4(f) benefit only Bear Stearns and are not available to any other company that may acquire control of Bear Stearns or CTC.³

¹ See 12 U.S.C. § 1843(f).

² 12 U.S.C. § 1843(f)(1)(A).

³ Both the Senate and the Conference Reports to CEBA state that the grandfather privileges held by the owner of a nonbank bank “may not be transferred to another organization, and will terminate if another company acquires, directly or indirectly, the bank involved.” See S. Rep. No. 100-19, 100th Cong., 1st Sess. 33 (1987); H.R. Conf. Rep. No. 100-261, 100th Cong., 1st Sess. 125 (1987).

You have indicated that Bear Stearns intends to create an employee stock ownership plan trust (“ESOP Trust”) that would hold approximately [] percent of the voting shares of Bear Stearns on behalf of employees of Bear Stearns and its subsidiaries. Shares would be contributed to the ESOP Trust as part of the deferred compensation plans (“Plans”) established for certain employees of Bear Stearns and its subsidiaries.⁴ The shares contributed to the ESOP Trust on behalf of an employee would be held by the ESOP Trust until such time as the employee’s interest in the shares had vested and the shares were distributed to the employee. You have represented that the Plans are not limited to senior executive officers or other management officials of Bear Stearns. In this regard, you have represented that approximately [] percent of the total number of employees of Bear Stearns and its subsidiaries participate in the Plans and, thus, would have shares of Bear Stearns transferred to the ESOP Trust on their behalf.

An unaffiliated bank, Wilmington Trust Company, Wilmington, Delaware, will act as trustee and administrator of the ESOP Trust. The ESOP Trust would not have any directors, officers, or employees, and would not engage in any activities other than holding and voting the Bear Stearns shares in the ESOP Trust in the manner described below.

You have indicated that the establishment of the ESOP Trust would have the effect of providing an employee that participates in, and receives allocations of shares of Bear Stearns pursuant to, the Plans the ability to vote the shares allocated to the employee and thereby to have a larger voice in the management of Bear Stearns. In this regard, you have represented that the ESOP Trust will vote the shares held on behalf of an employee in accordance with instructions received from the employee. Any unallocated shares in the ESOP Trust,⁵ as well as any shares for which no voting instructions have been received from the relevant employee, will be voted by the ESOP Trust in the same percentages as allocated shares for which voting instructions were received.

For purposes of the BHC Act, a company has control over another company if the first company (i) directly or indirectly, or acting through one or more other persons, owns, controls, or has power to vote 25 percent or more of any class of voting securities of the second company; (ii) controls in any manner the election of a majority of the directors of the second company; or (iii) directly or indirectly exercises a

⁴ You have indicated that Bear Stearns expects to contribute available treasury shares to the ESOP Trust.

⁵ The ESOP Trust may hold unallocated shares if, for example, the employee to whom the shares initially were allocated terminates his or her employment with Bear Stearns before the employee’s shares have vested.

controlling influence over the policies or management of the second company. The Board's Regulation Y also sets forth a set of rebuttable presumptions of control.

The ESOP Trust would not own, control, or hold with power to vote 25 percent or more of a class of voting securities of, or control the election of a majority of the directors of, Bear Stearns or CTC. In addition, the ESOP Trust would not trigger any of the rebuttable presumptions of control in Regulation Y with respect to Bear Stearns or CTC. Accordingly, the ESOP Trust would only be deemed to control Bear Stearns or CTC for purposes of the BHC Act if the Board were to find that the ESOP Trust exercised a controlling influence over the policies or management of Bear Stearns or CTC.

The size and nature of the ESOP Trust's proposed equity investment in Bear Stearns raise the issue of whether the ESOP Trust has a significant influence over the policies and management of Bear Stearns. To address concerns that it might have the ability to exercise a controlling influence over Bear Stearns, the ESOP Trust has committed that it:

- (1) Will not, without the prior written approval of the Board, acquire 25 percent or more of any class of the voting securities or otherwise acquire control of any bank or bank holding company, Bear Stearns, or CTC;
- (2) Will notify the Board prior to acquiring any nonvoting equity interest in any bank or bank holding company, Bear Stearns, or CTC, of the terms of any such investment;
- (3) Will not make any investments that could not be made by a bank holding company under the BHC Act, and will provide notification to the Board prior to acquiring more than 5 percent of the voting securities of any company other than Bear Stearns.

In view of all the facts of record in this case – including in particular the commitments made by the ESOP Trust, the pass-through voting mechanism of the ESOP Trust, the lack of director and employee interlocks between the ESOP Trust and Bear Stearns, and the broad nature of employee eligibility in the ESOP Trust – the Legal Division would not recommend (i) that the Board find that the ESOP Trust would control Bear Stearns or CTC for purposes of the BHC Act or (ii) that the ESOP Trust would be a bank holding company under the BHC Act.

Moreover, under these circumstances, the Legal Division would not recommend that the Board determine that the transactions described above would cause

Bear Stearns to lose its grandfather rights under section 4(f) of the BHC Act.⁶ Of course, after consummation of the proposed transactions, CTC and Bear Stearns must continue to comply with the conditions applicable to a nonbank bank and a grandfathered holding company, respectively, under the BHC Act.

This opinion is based on the specific facts and representations in your letter and in communications with Board staff, and any change in the facts or representations, such as any increase in the percentage of voting securities of Bear Stearns held by the ESOP Trust, should be communicated immediately to Board staff and could result in a different conclusion. This opinion is limited to this proposal and does not apply to any other transaction. If you have any questions about this letter, please contact Kieran J. Fallon, Assistant General Counsel, at (202) 452-5270, or Mark E. Van Der Weide, Senior Counsel, at (202) 452-2263.

Sincerely,

(signed) Scott G. Alvarez

⁶ See Letter from J. Virgil Mattingly, General Counsel of the Board, to Dennis Rilinger, Esq., dated December 31, 1990.