

MELTDOWN: LITIGATING THE CREDIT CRISIS
PRESENTED TO GARDERE WYNNE SEWELL LLP
DECEMBER 4, 2008

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Ace Mortgage Brokers

"We Make Your Dreams Come True"

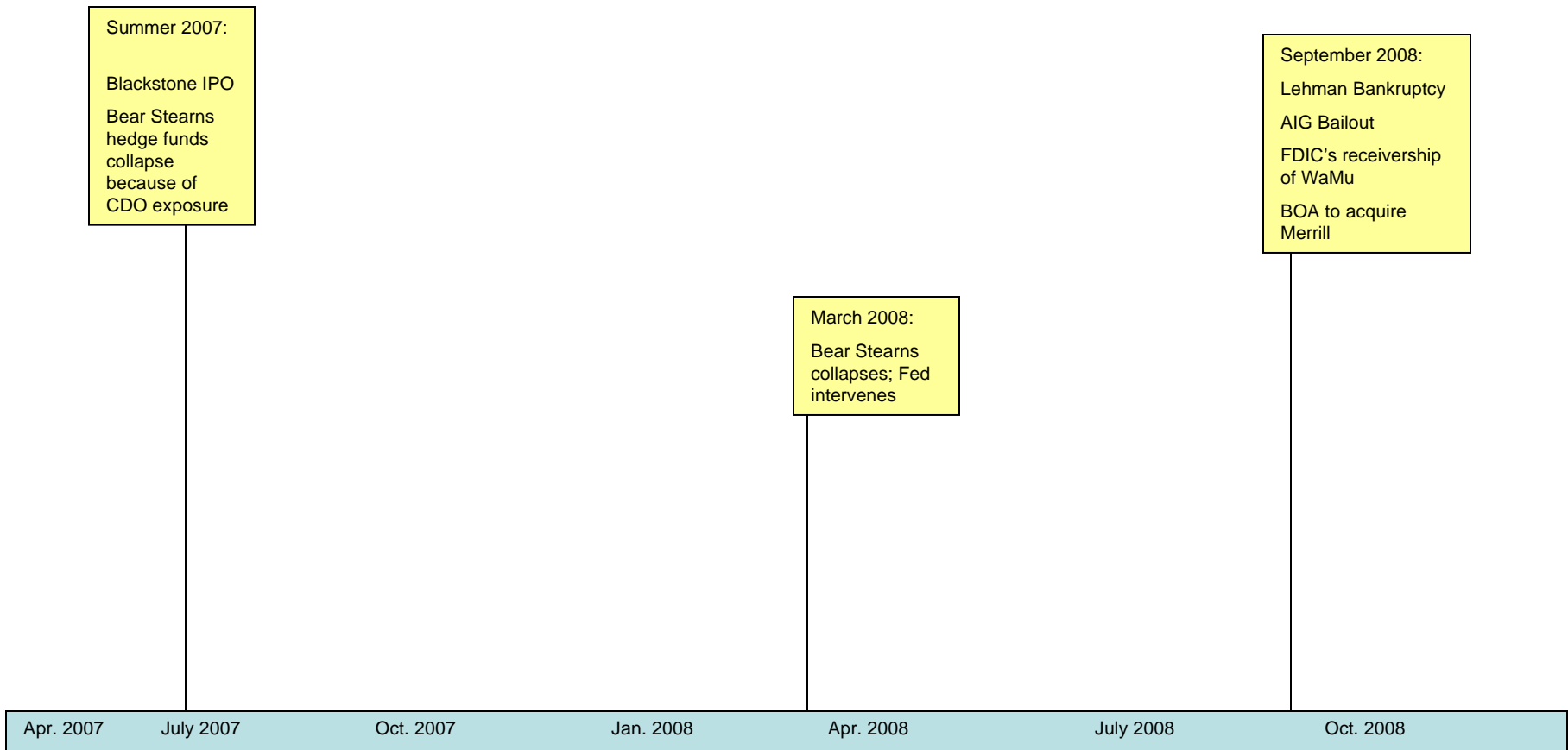
And we can give you a really really low interest rate for a few years. We'll raise it later, okay?

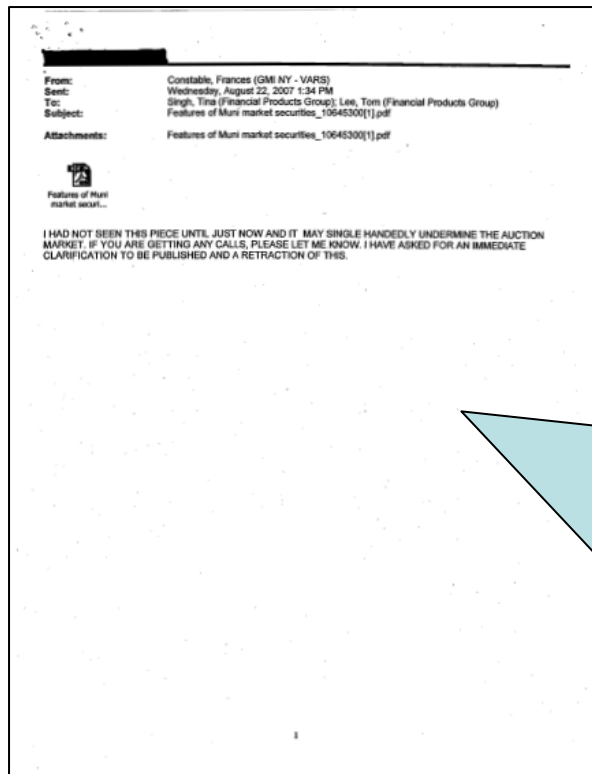
Sure, no problem. Umm, there's one other thing... my employer is a real prick and might not verify my employment. Would that be a problem?

Nope. We can get you a special "Liar's Loan" and you can verify your own employment and income!



Credit Crisis Timeline





Frances Constable, August 22, 2007:

“I HAD NOT SEEN THIS PIECE UNTIL JUST NOW AND ***IT MAY SINGLE HANDEDLY UNDERMINE THE AUCTION MARKET.*** . . . I HAVE ASKED FOR AN IMMEDIATE CLARIFICATION TO BE PUBLISHED AND A ***RETRACTION*** OF THIS.” [Emphasis added.]



Merrill Lynch

[REDACTED]

From: Price, John (Americas Credit Sales & Trading)
Sent: Monday, November 19, 2007 6:40 PM
To: [REDACTED]
Subject: RE: Updated: [REDACTED]

What a rining today was. Worst I have seen and I'm short out the wazzoo....
This could be a capitulation trade, but I think the first few bounces should be sold.

[REDACTED]

-----Original Message-----
From: [REDACTED] (mailto:[REDACTED])
Sent: Monday, November 19, 2007 6:32 PM
To: Price, John (Americas Credit Sales & Trading)
Subject: Re: Updated: [REDACTED]

Sent from my Verizon Wireless BlackBerry

-----Original Message-----
From: "Price, John (Americas Credit Sales & Trading)" <[REDACTED]>
Date: Mon, 19 Nov 2007 17:48:40
To: [REDACTED]
Subject: RE: Updated: [REDACTED]

[REDACTED]

-----Original Message-----
From: [REDACTED] (mailto:[REDACTED])
Sent: Monday, November 19, 2007 5:48 PM
To: Price, John (Americas Credit Sales & Trading)
Subject: Re: Updated: [REDACTED]

Post:
[REDACTED]

Sent from my Verizon Wireless BlackBerry

-----Original Message-----
From: "Price, John (Americas Credit Sales & Trading)" <[REDACTED]>
Date: Mon, 19 Nov 2007 10:24:51
To: [REDACTED]
Subject: RE: Updated: [REDACTED]

Thanks [REDACTED] ... Will call later. Market is collapsing. No more \$2k dinners at CRU!! The Financials are being invicerated! More firings

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John Price, November 19, 2007:

"Market is collapsing. No more \$2k dinners at CRU!! More firings over at Citi . . . Inventory flooding the street. . ."



Merrill Lynch

Message

From: Constable, Frances (GMI NY - VARS)
Sent: Monday, November 26, 2007 12:06 PM
To: Price, John (Americas Credit Sales & Trading)
Subject: RE: Limit Report: Municipal Markets Group by Risk Factor @ 11-23-2007 12:27 PM

That would be too scary, as the fall rates are generally 12%. We are working it higher to at least be consistent with where we have the T.E. closed end funds. The gloves are off and we are not concerned with issuer perception of our abilities and the competition. Gotta move those microwave ovens!

-----Original Message-----
From: Price, John (Americas Credit Sales & Trading)
Sent: Monday, November 26, 2007 11:10 AM
To: Constable, Frances (GMI NY - VARS); Liu, Peter (Market Risk Management)
Cc: Curland, Edward (GMI NYMUN); Lawlor, John J. (GMI Municipal Markets)
Subject: RE: Limit Report: Municipal Markets Group by Risk Factor @ 11-23-2007 12:27 PM

Is it a pricing level? Meaning - can we cheapen the levels close to the fall rates to clear more product? This is what we are doing in DFID and Taxable correct?

-----Original Message-----
From: Constable, Frances (GMI NY - VARS)
Sent: Monday, November 26, 2007 10:34 AM
To: Liu, Peter (Market Risk Management)
Cc: Curland, Edward (GMI NYMUN); Lawlor, John J. (GMI Municipal Markets); Price, John (Americas Credit Sales & Trading)
Subject: RE: Limit Report: Municipal Markets Group by Risk Factor @ 11-23-2007 12:27 PM

Peter, the auction market desk Muni position is currently \$1.163bn (\$908MM of tax-able and \$165.7MM taxable), slightly over our risk limit of \$1Bn. Much of the back up stems from the Thanksgiving week where we had double auctions on Wednesday and virtually no buying on Wednesday or Friday. That notwithstanding, we continue to experience selling from larger accounts and concern from retail about the liquidity in the markets in general. Not sure when we should be able to get back below our limit but have let our auction rates reset up between 4.00-4.25%, versus SIFMA Index of 3.58%. Much of the street is following suit.

-----Original Message-----
From: Liu, Peter (Market Risk Management)
Sent: Friday, November 23, 2007 12:27 PM
To: Brewer, Jim (GMI NY - VARS); White, Christopher (GMI - NYMUN); Renzo, Anthony (GMI - NY SWAPS); Van Beek, Jeremy (Market Risk Management); Keeler, Ken (GMI NYMUN); Thomodsgard, Amy (GMI NYMUN); Lawlor, John J. (GMI Municipal Markets); Pecorella, Vincent (GMI - NY SWAPS); Curland, Edward (GMI NYMUN); Constable, Frances (GMI NY - VARS); Guardia, Ben (GMI NYMUN); Andersen, Dave (GMI NYMUN); Cornacchia, Raphael (GMI - NY SWAPS); Dobitsch, Phil (GMI - NYMUN); Liu, Peter (Market Risk Management); Pease, Tom (GMI NYMUN); Turst, Joseph (GMI NY MUND); Yaman, Karen (Market Risk Management); Yates, George (London); Yenser, Jana (Market Risk Management)
Subject: Limit Report: Municipal Markets Group by Risk Factor @ 11-23-2007 12:27 PM

Merrill Lynch Change My Recent Preferences
Municipal Markets Group by Risk Factor

Published - Recipients: [REDACTED]@MIL.COM; [REDACTED]@MIL.COM; [REDACTED]@MIL.COM; [REDACTED]@MIL.COM; [REDACTED]@exchange.mil.com; [REDACTED]@mil.com; [REDACTED]@exchange.mil.com; [REDACTED]@mil.com; [REDACTED]@exchange.mil.com; [REDACTED]@exchange.mil.com; [REDACTED]@MIL.COM; Dobitsch, Phil; Liu, Peter; Pease, Tom; Turst,

Frances Constable, November 26:

“[W]e continue to experience selling from larger corporate accounts and concern from retail about the liquidity in the markets in general.

“The gloves are off and we are not concerned with issuer perception of our abilities and the competition. ***Gotta move those microwave ovens***”
 [Emphasis added]



From: Price, John (Americas Credit Sales & Trading)
Sent: Wednesday, December 19, 2007 11:06 AM
To: Lin, Ming (Market Risk Management)
Cc: Brown, Scott (ML FICC Principal)
Subject: FW: AMPS Management Update

Attachments: Management Update.PPT



Management
p04e.ppt (2 M)

King - here is an update on the AMPS business and the inventory. Please take a look at the below and let us know if you have any questions.

Thanks - JP

-----Original Message-----

From: Price, John (Americas Credit Sales & Trading)
Sent: Wednesday, December 19, 2007 10:51 AM
To: Sobotka, David (GMI - FICC); Brown, Scott (ML FICC Principal)
Cc: Schulz, Jeff (FICC COO)
Subject: AMPS Management Update

David & Scott -

Attached please find an AMPS presentation that was prepared earlier this month. Please be aware that the contagion that has engulfed all has been especially harsh on the AMPS product. Previously it was a business that used very little Balance Sheet with a high ROA. Pay particular attention to the last 2 pages where the revenue is detailed for the past several years for both Corporates and Munis (we run the Muni AMP business but receive no P&L or VICP). Obviously things have changed - the question is for how long?

Inventory higher yesterday. Fighting hard to get it down,
Munis \$1.3bln
AMPS \$1.8bln

TOTAL AMPS INVENTORY

DED	627,850,000
FLTS	947,825,000
TXEL CEF	369,329,000
TXEL Muni	359,420,000
TXEL Structured	534,175,000
TXEL Stud Loan	114,200,000
TXER CEF	158,850,000
Grand Total	3,197,545,000

PERVED

DED	627,850,000
TXEL CEF	369,329,000
TXEL Structured	534,175,000
TXEL Stud Loan	114,200,000
TXER CEF	158,850,000
Grand Total	1,808,300,000

MUTESH

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John Price, December 19, 2007:

“Please be aware that ***the contagion that has engulfed all*** has been especially harsh on the AMPS product . . . Inventory higher yesterday. Fighting hard to get it down.” [Emphasis added.]



Merrill Lynch

Credit Crisis Timeline

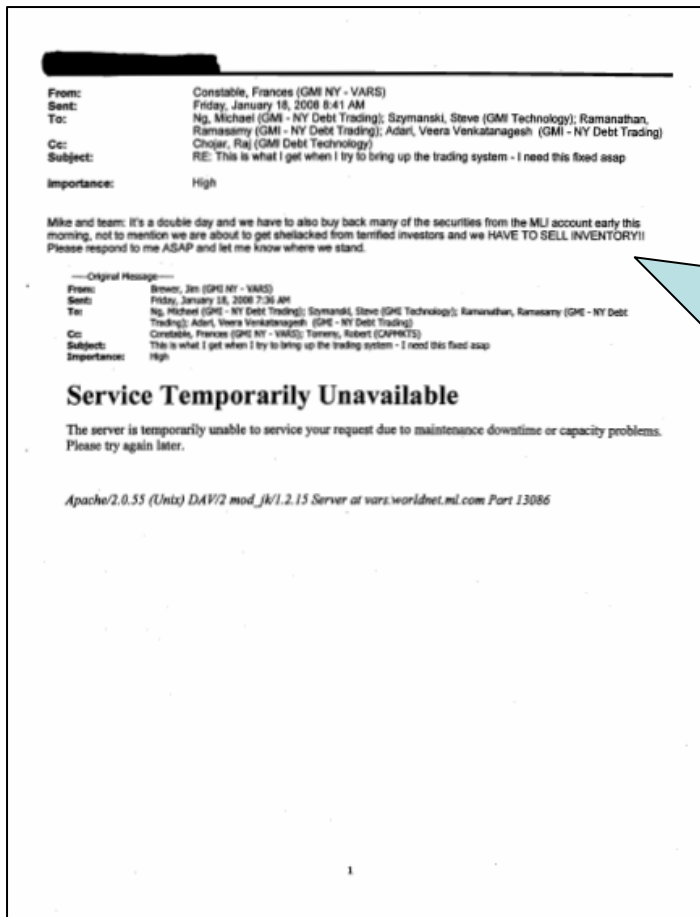
Summer 2007:
Blackstone IPO
Bear Stearns
hedge funds
collapse
because of
CDO exposure

November 2007:
"Inventory flooding the
street..."
"Gotta Move Those
Microwave Ovens"

March 2008:
Bear Stearns
collapses; Fed
intervenes

September 2008:
Lehman Bankruptcy
AIG Bailout
FDIC's receivership
of WaMu
BOA to acquire
Merrill

Apr. 2007 July 2007 Oct. 2007 Jan. 2008 Apr. 2008 July 2008 Oct. 2008



Frances Constable, January 18, 2008:
“Mike and team: It’s a double day and we have to also buy back many of the securities from the MLI account early this morning, not to mention we are about to get shallacked from terrified investors and we HAVE TO SELL INVENTORY!!”



From: Constable, Frances (GMI NY - VARS)
Sent: Tuesday, January 29, 2008 4:45 PM
To: Price, John (Americas Credit Sales & Trading)
Subject: FW: CEF Insights 1/29/08: Leverage, Real Estate

Attachments: CEF Insights_01_29_08.pdf

Its like the Sorcerer's Apprentice...cant someone make these people stop bucketing us with water

-----Original Message-----

From: Frangas, Nicholas (GPC Investments & Wealth Management)
Sent: Tuesday, January 29, 2008 4:40 PM
Subject: CEF Insights 1/29/08: Leverage, Real Estate

INTERNAL USE ONLY

CEF Leverage...Funding Issues Ahead?

The closed-end auction rate preferred market recently experienced its first failed auction since 1990. Although it was a relatively small number of shares that failed, there have been a lot of questions surrounding this event.

For Contrarian Investors...

A number of investors, with the correct risk appetite of course, have begun to speculate with renewed investments in the housing market. In light of the past years' declines in real estate, many closed end funds that are concentrated in real estate securities have sold off drastically. Although the distribution yields of these securities have increased due to market weakness, for the most part the NAV of these funds have declined as well, indicating that there are fundamental issues with many funds.



CEF
s_01_29_08.pdf

Please note: Some of the funds mentioned in this newsletter might require 6-6 approval to solicit. Please refer to the *Comprehensive List of Closed-end Funds Approved for Solicitation without 6-6 Approval* located on the GPC Business Daily website for confirmation. Financial advisors will have to contact their branch compliance managers to obtain the approval.

Frances Constable, January 29, 2008:

[In response to news that “the closed-end auction rate preferred market recently experienced its first failed auction since 1990]:

“Its like the Sorcerer’s Apprentice...cant someone make these people stop bucketing us with water...”



Credit Crisis Timeline

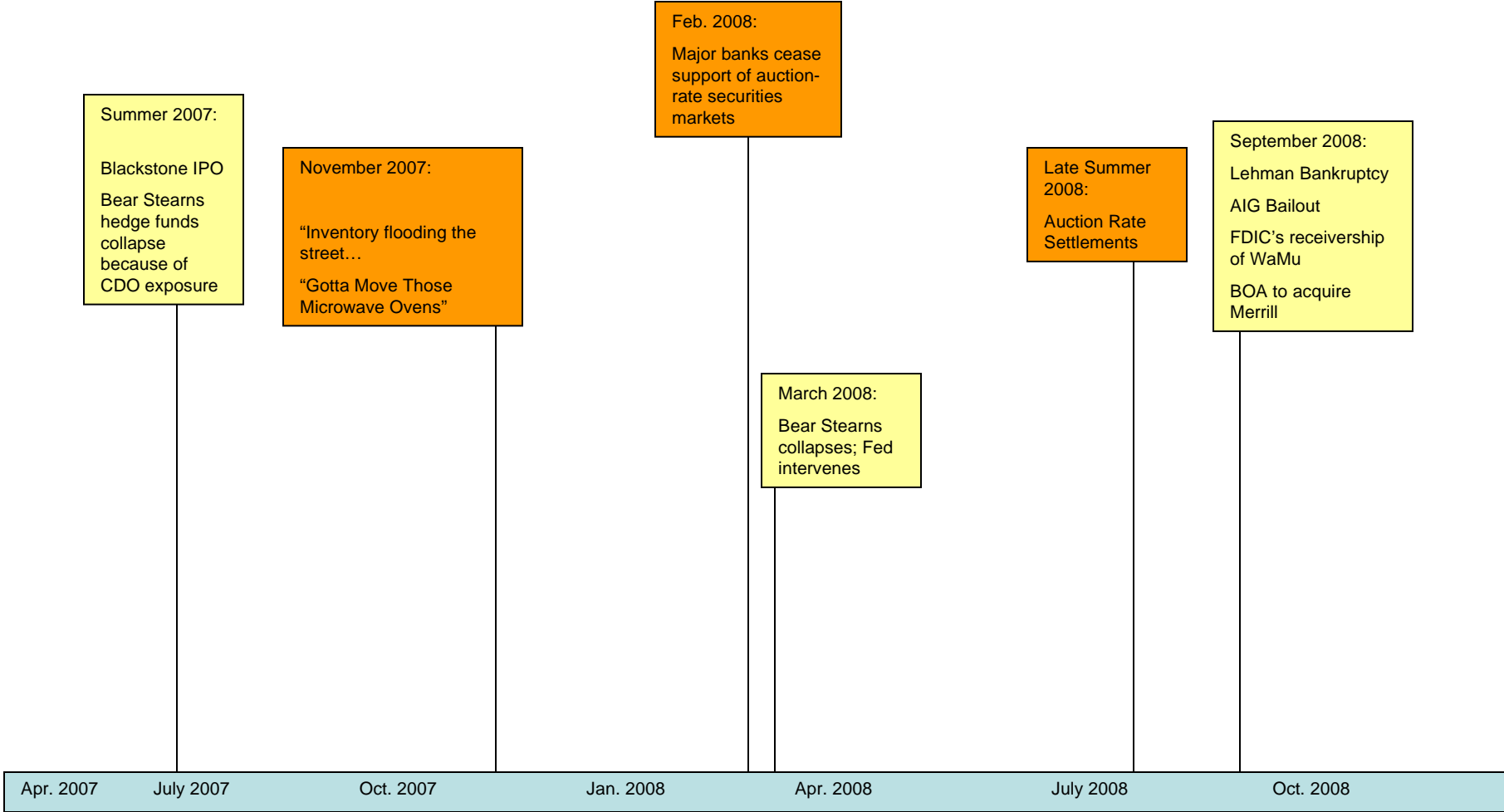


Table 1: Example of Basic CDO Capital Structure

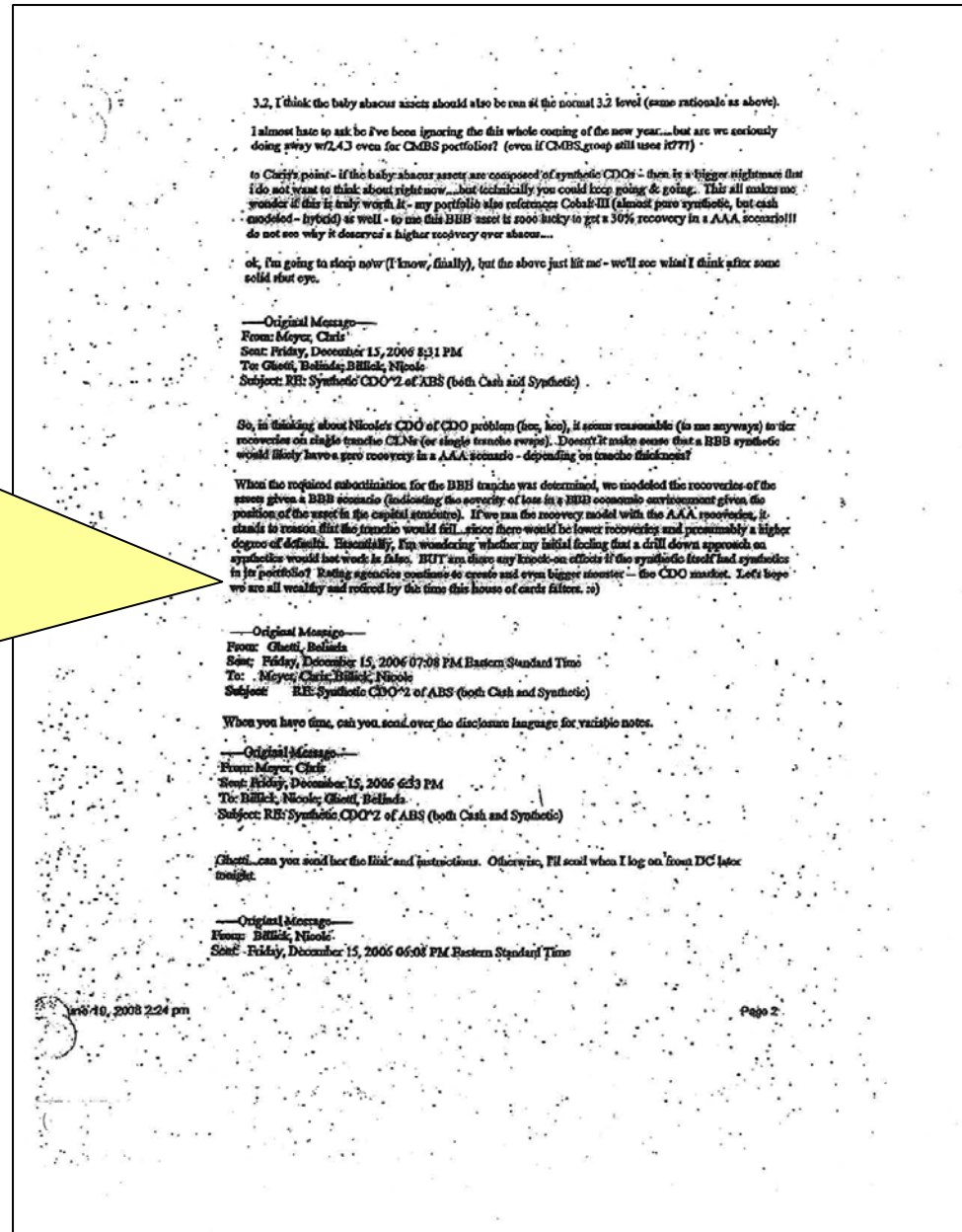
Class	Amount (\$ millions)	Pct. of Deal	Subordina- tion (%)	Ratings (Moody's/S&P)
Class A	243.0	81.0	19.0	Aaa/AAA
Class B	13.5	4.5	14.5	Aa2/AA
Class C	10.5	3.5	11.0	A2/A
Class D	9.0	3.0	8.0	Baa2/BBB
Class E	9.0	3.0	5.0	Ba2/BB
Equity	15.0	5.0	0.0	not rated

December 15, 2006:

“Rating agencies continue to create an even bigger monster – the CDO market. Let’s hope we are all wealthy and retired by the time this house of cards falters. :o)”

--Christopher Meyer,
Associate Director,
Global CDO Group

STANDARD
& POOR'S



April 2007 IM exchange

Shannon Mooney:
“Model def does not
capture half the risk.”

Rahul Shah: “We should
not be rating it.”

Mooney: “We rate every
deal It could be
structured by cows and
we would rate it”

2007 3:55:44 PM EDT Shah, Rahul Dilip (Structured Finance - New York): IM
session is being recorded and may be reviewed for compliance by McGraw-Hill

2007 3:56:35 PM EDT Mooney, Shannon: i didn't really notice...but now that i think

2007 3:57:00 PM EDT Shah, Rahul Dilip (Structured Finance - New York): well she
doesn't have anything of substance to say...but keeps thinking that she does.
2007 3:57:15 PM EDT Shah, Rahul Dilip (Structured Finance - New York): (I'm done

2007 3:57:30 PM EDT Mooney, Shannon: k go take a nap

2007 3:58:19 PM EDT Mooney, Shannon: see you later

2007 3:58:24 PM EDT Shah, Rahul Dilip (Structured Finance - New York): ok

2007 3:58:42 PM EDT Shah, Rahul Dilip (Structured Finance - New York): btw - that

Thursday, April 05, 2007 3:59:05 PM EDT Mooney, Shannon: i know right..model def does not capture
half of the risk

Thursday, April 05, 2007 3:59:08 PM EDT Mooney, Shannon: risk

Thursday, April 05, 2007 3:59:09 PM EDT Shah, Rahul Dilip (Structured Finance - New York): we should
not be rating it

Thursday, April 05, 2007 3:59:17 PM EDT Mooney, Shannon: we rate every deal

Thursday, April 05, 2007 3:59:30 PM EDT Mooney, Shannon: it could be structured by cows and we
would rate it

Thursday, April 05, 2007 3:59:54 PM EDT Shah, Rahul Dilip (Structured Finance - New York): but there's
a lot of risk associated with it - I personally don't feel comfy signing off as a committee member.

“[By 1994,] [m]anagement undertook a concerted effort to make the firm more issuer-friendly, since issuers largely paid the bills by then. In my view, the focus of Moody’s shifted from protecting investors to being a marketing-driven organization.”

Jerome Fons, Ph.D., former member of Moody’s Credit Policy Committee and Federal Reserve economist -- Testimony, Oct. 22, 2008, Before the House Committee on Oversight and Reform



Moody's Investors Service

“Originators of structured securities typically chose the agency with the lowest standards, engendering a race to the bottom in terms of rating quality.”



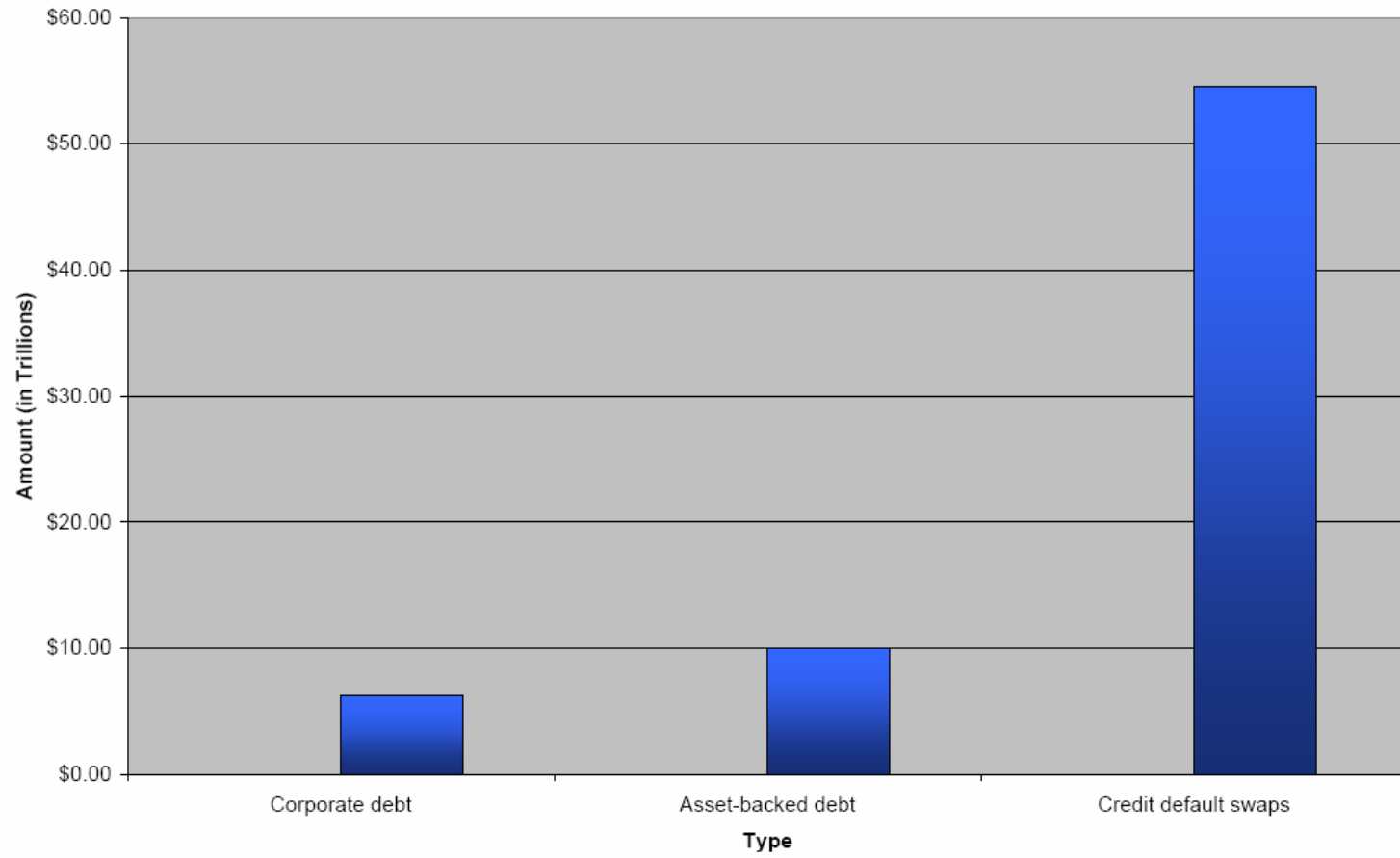
Moody's Investors Service

“Ratings became embedded or ‘hard-coded’ into investment guidelines, bond indices, and private contracts. . . . The over-reliance on statistical, backward-looking models needs to be replaced by an increase reliance on common sense.”



Moody's Investors Service

Credit Default Swaps vs. Other Debt Instruments



CDO Plus
Hedge Fund
("protection seller")

← 2.75% per annum

750,000 ("initial margin") →

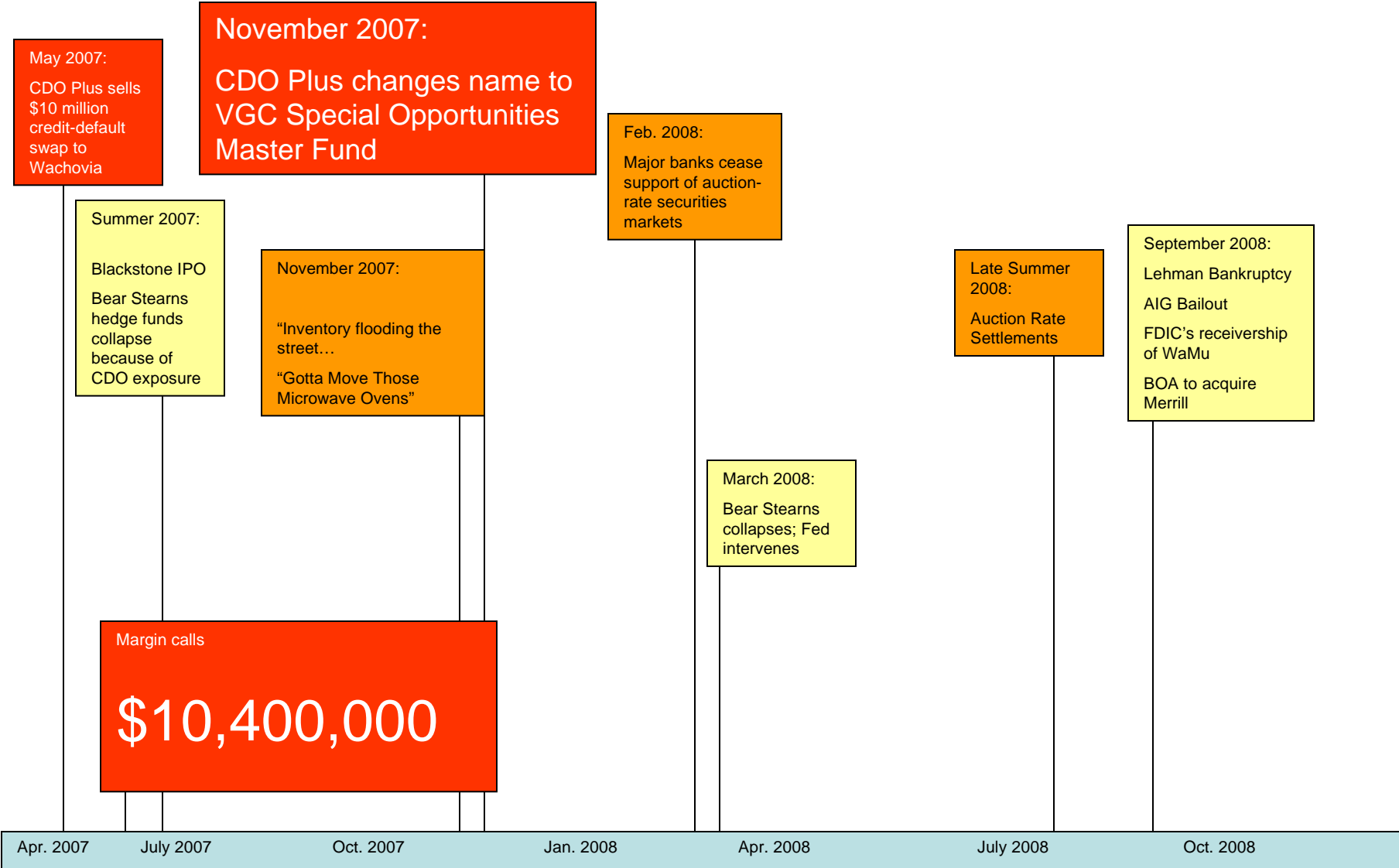
Wachovia
("protection buyer")

"reference obligation" – Forge ABS High Grade
CDO –

\$10,000,000 of class B tranche

Maturity: 2053

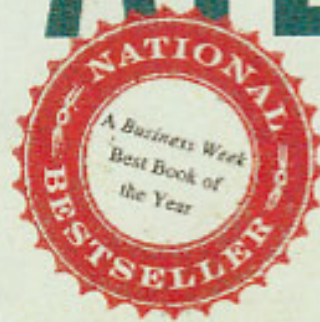
Credit Crisis Timeline





THE RISE AND FALL OF
LONG-TERM CAPITAL MANAGEMENT

WHEN GENIUS FAILED



"Story-telling
journalism at its best."
—*The Economist*

ROGER LOWENSTEIN

Author of Buffett: The Making of an American Capitalist

THE
BLACK SWAN



The Impact of the
HIGHLY IMPROBABLE

Nassim Nicholas Taleb