BEAR STEARNS COMPANIES INC
Form 10-K
February 13, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended November 30, 2005.**

or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____________ to _____________

Commission file number: 1-8989

THE BEAR STEARNS COMPANIES INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**13-3286161**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

383 Madison Avenue, New York, New York 10179
(212) 272-2000
(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $1.00 per share	New York Stock Exchange
Depositary Shares, each representing a one-fourth interest in a share of 6.15% Cumulative Preferred Stock, Series E	New York Stock Exchange
Depositary Shares, each representing a one-fourth interest in a share of 5.72% Cumulative Preferred Stock, Series F	New York Stock Exchange
Depositary Shares, each representing a one-fourth interest in a share of 5.49% Cumulative Preferred Stock, Series G	New York Stock Exchange
7.8% Trust Issued Preferred Securities, of Bear Stearns Capital Trust III (and registrant s guarantee thereof)	New York Stock Exchange
Euro Floating Rate Global Notes Due July 27, 2012	New York Stock Exchange
Principal Protected Sector Selector Notes Due 2008	American Stock Exchange
Principal Protected Notes Linked to the S&P 500 Index Due 2008	American Stock Exchange
Principal Protected Notes Linked to the Price Performance of the Nasdaq - 100 Index Due 2009	American Stock Exchange
Principal Protected Notes Linked to the S&P 500 Index Due 2009	American Stock Exchange
Principal Protected Notes Linked to the Dow Jones Industrial Average Due 2011	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule12b-2 of the Exchange Act). Yes o No x

At May 31, 2005, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately $10,347,623,434. For purposes of this information, the outstanding shares of common stock owned by directors and executive officers of the registrant were deemed to be shares of common stock held by affiliates.

On February 6, 2006, the registrant had 119,367,360 outstanding shares of common stock, par value $1.00 per share, which is the registrant s only class of common stock.

DOCUMENTS INCORPORATED BY REFERENCE:

Parts II and IV of this Form 10-K incorporate information by reference from certain portions of the registrant s 2005 Annual Report to Stockholders. The information required to be furnished pursuant to Part III of this Form 10-K will be set forth in, and incorporated by reference from, the registrant s definitive proxy statement for the annual meeting of stockholders to be held April 11, 2006, which definitive proxy statement will be filed by the registrant with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended November 30, 2005.

THE BEAR STEARNS COMPANIES INC.

ANNUAL REPORT ON FORM 10-K FOR FISCAL YEAR ENDED NOVEMBER 30, 2005

2

PART I

Item 1. Business.

(a) *General Development of the Business*

The Bear Stearns Companies Inc. (the Company) was incorporated under the laws of the State of Delaware on August 21, 1985. 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 a leading investment banking, securities and derivatives trading, clearance and brokerage firm serving corporations, governments, institutional and individual investors worldwide. BSSC, a subsidiary of Bear Stearns, provides professional and correspondent clearing services, in addition to clearing and settling customer transactions and certain proprietary transactions of the Company. The Company succeeded on October 29, 1985 to the business of Bear, Stearns & Co., a New York limited partnership (the Partnership). In addition to conducting a substantial portion of its operating activities through certain of its regulated subsidiaries noted above, (Bear Stearns, BSSC, BSIL and BSB), the Company also conducts activities through the following wholly owned subsidiaries: Bear Stearns Global Lending Limited; Custodial Trust Company; Bear Stearns Financial Products Inc.; Bear Stearns Capital Markets Inc.; Bear Stearns Credit Products Inc.; Bear Stearns Forex Inc.; EMC Mortgage Corporation; Bear Stearns Commercial Mortgage, Inc. and through its majority owned subsidiary Bear Hunter Holdings LLC. As used in this report, the Company refers (unless the context requires otherwise) to The Bear Stearns Companies Inc., its subsidiaries and the prior business activities of the Partnership.

The Company s website is http://www.bearstearns.com. The Company makes available free of charge on its website its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Forms 3, 4 and 5 filed on behalf of directors and executive officers and any amendments to such reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission (the SEC). Also posted on the Company s website, and available in print upon request of any stockholder to the Investor Relations Department, are charters for the Company s Audit Committee, Compensation Committee, Corporate Governance Committee, Nominating Committee and Qualified Legal Compliance Committee. Copies of the Corporate Governance Guidelines and the Code of Business Conduct and Ethics (the Code) governing our directors, officers and employees are also posted on the Company s website within the Corporate Governance section under the heading About Bear Stearns and are available in print upon request of any stockholder to the Investor Relations Department.

Within the time period required by the SEC and the New York Stock Exchange, Inc. (the NYSE) the Company will post on its website any modifications to the Code and any waivers applicable to Senior Executives, as defined in the Code.

The Investor Relations Department can be contacted at The Bear Stearns Companies Inc., 383 Madison Avenue, New York, New York 10179, Attn.: Investor Relations, telephone: (212) 272-2000.

(b) *Financial Information about Industry Segments*

The Company is primarily engaged in business as a securities broker and dealer operating in three principal segments: Capital Markets, Global Clearing Services and Wealth Management. These segments are analyzed separately due to the distinct nature of the products they provide and the clients they serve. Certain Capital Markets products are distributed by the Wealth Management and Global Clearing Services distribution networks, with the related revenues of such intersegment services allocated to the respective segments.

- 3 -

The Capital Markets segment comprises 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 works 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, convertible bonds, over-the-counter (OTC) equities, equity derivatives, risk and convertible arbitrage and through a consolidated joint venture, the NYSE, American Stock Exchange (AMEX) and International Securities Exchange (ISE) specialist and market-making activities. Fixed income includes sales, trading 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, foreign exchange, 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, arbitrageurs and other professional investors. Fully disclosed clients engage in either the retail or institutional brokerage business. At November 30, 2005, the Company held approximately $258.1 billion of equity in Global Clearing Services client accounts.

The Wealth Management segment is composed of the Private Client Services (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. At November 30, 2005, PCS had approximately 500 account executives in its principal office, six regional offices, three satellite offices and two international offices. Asset management manages equity, fixed income and alternative assets for corporate pension plans, public systems, endowments, foundations, multi-employer plans, insurance companies, corporations, families and high-net-worth individuals in the United States (US) and abroad. The asset management area had $41.9 billion in assets under management at November 30, 2005, which compared to $37.8 billion in assets under management at November 30, 2004.

Financial information regarding the Company s business segments and foreign operations as of November 30, 2005, November 30, 2004, and November 30, 2003 and for the fiscal years ended November 30, 2005, November 30, 2004 and November 30, 2003 is set forth under Item 8. Financial Statements and Supplementary Data, in Note 19 of Notes to Consolidated Financial Statements, entitled Segment and Geographic Area Data, and is incorporated herein by reference.

(c) *Narrative Description of Business*

The business of the Company includes: market-making and trading in US government, government agency, corporate debt and equity, mortgage-related, asset-backed, municipal securities and high yield products; trading in options, futures, foreign currencies, interest rate swaps and other derivative products; securities, options and futures brokerage; providing securities clearance services; managing equity and fixed income assets for institutional and individual clients; financing customer activities; securities lending; securities and futures arbitrage; involvement in specialist and market-making activities on the NYSE, AMEX and ISE; underwriting and distributing securities; arranging for the private placement of securities; assisting in mergers, acquisitions, restructurings and leveraged transactions; making principal investments in leveraged acquisitions; engaging in commercial real estate activities; investment management and advisory services; fiduciary, custody, agency and securities research services.

The Company s business is conducted from its principal offices in New York City; from domestic regional offices in Atlanta, Boston, Chicago, Dallas, Denver, Los Angeles, San Francisco, San Juan and Scottsdale; from representative offices in Beijing, Hong Kong, São Paulo and Shanghai; and through international offices in Dublin, Hong Kong, London, Lugano, Milan, Singapore and Tokyo. The Company s international offices provide services and engage in investment activities involving foreign clients and international transactions. Additionally, certain of these foreign offices provide services to US clients.

Bear Stearns and BSSC are broker-dealers registered with the SEC. Additionally, Bear Stearns is registered as an investment adviser with the SEC. Bear Stearns and/or BSSC are also members of the NYSE, all other principal US securities and futures exchanges, the National Association of Securities Dealers, Inc. (NASD), the National Futures Association (NFA) and the ISE. Bear Stearns is a primary dealer in US government securities as designated by the Federal Reserve Bank of New York.

BSIL is a full service broker-dealer based in London. BSIL is incorporated in the United Kingdom and is authorized and regulated by the Financial Services Authority (FSA).

BSB is an Ireland-based bank, which was registered in 1996 and subsequently granted a banking license on April 10, 1997 under the Irish Central Bank Act, 1971. BSB allows the Company s existing and prospective clients the opportunity of dealing with a banking counterparty. BSB is incorporated in Ireland.

Bear Stearns Global Lending Limited (BSGL) provides loans to certain Bear Stearns customers. BSGL is incorporated in the Cayman Islands.

Custodial Trust Company (CTC), a Federal Deposit Insurance Company (FDIC) insured New Jersey state chartered bank, offers a range of trust, lending and securities-clearance services. CTC provides the Company with banking powers including access to the securities and funds-wire services of the Federal Reserve System. CTC provides trust, custody, agency and securities lending services for institutional accounts; commercial and margin lending; the clearance of government securities for institutions and dealers; and the processing of mortgage and mortgage-related products, including derivatives and collateralized mortgage obligations products. At November 30, 2005, CTC held approximately $61 billion of assets for clients, including institutional clients such as pension funds, mutual funds, endowment funds and insurance companies. CTC is incorporated in the State of New Jersey.

Bear Stearns Financial Products Inc. (BSFP) transacts business as a triple-A-rated counterparty to eligible clients, offering a wide range of fixed income and equity derivative products. Eligible clients are those rated A3 or better by Moody s Investors Service, Inc. and A- or better by Standard & Poor s Ratings Services or counterparties acceptable to both rating agencies. BSFP transfers its market risk associated with derivative transactions to Bear Stearns Capital Markets Inc., an affiliate of BSFP and a wholly owned subsidiary of the Company. BSFP is incorporated in the State of Delaware.

Bear Stearns Capital Markets Inc. (BSCM) is engaged in fixed income derivatives transactions and hedges associated therewith. BSCM is incorporated in the State of Delaware.

Bear Stearns Credit Products Inc. (BSCPI) is engaged in credit derivatives transactions and hedges associated therewith. BSCPI is incorporated in the State of Delaware.

Bear Stearns Forex Inc. (BSFX) is a foreign exchange dealer engaged in foreign currency transactions and hedges associated therewith. BSFX is incorporated in the State of Delaware.

EMC Mortgage Corporation (EMC) is a US Department of Housing and Urban Development (HUD) and Freddie MAC approved lender based in Irving, Texas. EMC purchases both conforming and non-conforming, investment-grade and non-investment grade, conventional fixed rate and adjustable rate residential mortgage loans with servicing released or retained and sells such loans to investors. EMC also purchases and sells residual certificates and mortgage servicing rights. EMC is incorporated in the State of Delaware.

Bear Stearns Commercial Mortgage, Inc. (BSCMI) is primarily engaged in the origination and securitization of commercial mortgage loans for resale in the form of pass-through securities (certificates). These certificates represent fractional and undivided interests in pools of mortgage loans held in a trust. BSCMI is incorporated in the State of New York.

Bear Hunter Holdings LLC (BHH) is a Delaware limited liability company jointly owned by the Company and Hunter Partners LLC. Bear Wagner Specialists LLC (Bear Wagner), BHH s principal wholly owned subsidiary, is a registered broker dealer primarily engaged in specialist and market-making activities on the NYSE, AMEX and ISE.

As of November 30, 2005, the Company had 11,843 employees.

The following areas are included in the three business segments mentioned above in Item 1(b).

Equities

General. The Company provides customers with liquidity, sales and trading expertise and equity research in products such as domestic and international equities, block trading, convertible bonds, OTC equities, equity derivatives, risk and convertible arbitrage and through our consolidated joint venture, NYSE, AMEX and ISE specialist and market-making activities.

Options and Index Products. The Company provides an array of equity and index option-related execution services to institutional and individual clients. The Company utilizes sophisticated research and computer modeling to formulate specific recommendations relating to options and index trading.

Arbitrage. The Company engages for its own account in both classic and risk arbitrage. The Company s risk arbitrage activities generally involve the purchase of securities at a discount from a value that is expected to be realized if a proposed or anticipated merger, recapitalization, tender offer or exchange offer is consummated. In classic arbitrage, the Company seeks to profit from temporary discrepancies (i) between the price of a security in two or more markets, (ii) between the price of a convertible security and its underlying security, (iii) between securities that are, or will be, exchangeable at a future date and (iv) between the prices of securities with contracts settling on different dates. The Company also examines relative value strategies. These strategies focus on pairs of equities or different levels of the capital structure of the same firm. In these relative value cases, the Company believes strong reasons exist for the prices of the securities to be highly correlated.

Strategic Structuring and Transactions (SST). The Company targets mispriced assets using sophisticated models and proprietary quantitative methods. The Company maintains substantial proprietary trading and investment positions in domestic and foreign markets covering a wide spectrum of equity and commodity products which include the use of futures, listed and OTC options and swaps. The Company has equity ownerships in various power-related assets and has recently formed CalBear Energy L.P., a new energy marketing and trading venture to develop a significant customer business focused on physical natural gas and power trading and related structured transactions.

Equity Securities.

(i) *OTC.* The Company makes markets on a principal basis in common and preferred stocks, warrants and other securities traded on the NASD s Automated Quotation System and otherwise in the OTC market.

(ii) *Direct Access.* The Company operates a direct access business through Institutional Direct Inc, a broker-dealer and wholly owned subsidiary of Bear Stearns, by providing execution and operations services to qualified institutional investors. Such investors may directly access brokers on the floor of the NYSE and execute and service orders directly with them.

Equity Research. The Equity Research Department provides in-depth, thematic research underpinned by detailed financial models. The department offers research on more than 1,000 companies in approximately 100 industries (57% of the Standard & Poor s 500 Index and 76% of the market capitalization of the Standard & Poor s 500 Index), is widely recognized for high quality macro research and includes the #1 Institutional Investor ranked strategy and accounting teams. The coverage of US stocks is complemented by Latin, European and Asian research teams. The department provides independent third party research reports and ratings on US covered companies as well as foreign securities with liquid ADRs.

Convertible Securities. The Company engages in the sales and trading of equity-linked securities including convertible bonds, convertible preferreds, equity-linked notes and warrants. Market coverage includes the United States, Europe, Asia and Latin America.

Equity Sales. The Company is one of the leading firms in the US providing brokerage services to institutional investors. Institutional equity sales involves the execution of transactions in US and foreign (European, Latin and Asian) equity and equity-linked securities for domestic and foreign institutional customers and providing these customers with liquidity, trading expertise, trade execution, research and investment advice. The Company provides transaction services for institutional customers who trade in futures and futures-related instruments.

Block Stock and Portfolio Trading. The Company effects transactions in large baskets of securities with institutional customers. The Company also provides customers execution capabilities for baskets of equity securities using sophisticated trading systems and analytics. Transactions are handled on an agency basis whenever possible, but the Company may be required to take a long or short position in a security to the extent that an offsetting purchaser or seller is not immediately available, or to guarantee prices versus a benchmark (i.e. volume weighted average price).

Specialist and Market-Making. The Company engages in specialist and market-making activities on the NYSE, AMEX and ISE through participation in a majority-owned consolidated joint venture. Such joint venture performs specialist functions in NYSE-listed and AMEX-listed stocks and performs market-making functions for options traded on the ISE. The rules of these exchanges generally require specialists to maintain orderly markets in the securities in which they are specialists, which may require commitments of significant amounts of capital to the Company s specialist businesses. The market-making functions of a specialist involve risk of loss during periods of market fluctuation and volatility, since specialists are obligated to take positions in their issues counter to the direction of the market in order to minimize short-term imbalances in the auction market. Due to the occurrence of a Control Event (as defined in BHH s limited liability company agreement) that was triggered in December 2003, the Company began consolidating this entity in fiscal 2004.

Fixed Income

General. The Company makes inter-dealer markets and trades on a principal basis in a wide range of instruments including: US and foreign government securities; government agency securities; corporate debt; mortgages; mortgage-backed and other asset-backed securities; municipal and other tax-exempt securities and interest rate swaps and other derivative products. Bear Stearns is one of the largest dealers in the US in such fixed income securities. Inventories of fixed income securities are generally carried to facilitate sales to customers and other dealers.

US Government Bonds and Agency Obligations. Bear Stearns is designated by the Federal Reserve Bank of New York as a primary dealer in US government obligations. The Company participates in the auction of, and maintains proprietary positions in, US Treasury bills, notes, bonds, and stripped principal and coupon securities. The Company also participates as a selling group member and/or underwriter in the distribution of various US government agency and sponsored corporation securities and maintains proprietary positions in such securities. In connection with these activities, the Company enters into transactions in options, futures and forward contracts to hedge such positions.

- 7 -

As a primary dealer, Bear Stearns bids directly on all auctions of US government securities. Additionally, Bear Stearns furnishes periodic reports of its inventory positions and market transactions in US government securities to the Federal Reserve Bank of New York. Bear Stearns also buys and sells government securities directly with the Federal Reserve Bank of New York as part of the Federal Reserve Bank of New York s open-market activities. In addition, the Company engages in matched book activities, which involve acting as an intermediary between borrowers and lenders of short-term funds, mainly via repurchase agreements and reverse repurchase agreements. The objective of this matched book activity is to earn a positive spread between interest rates.

Mortgage-Related Securities and Products. The Company trades and makes markets in the following mortgage-related securities and products: Government National Mortgage Association (GNMA) securities; Federal Home Loan Mortgage Corporation (FHLMC) participation certificates; Federal National Mortgage Association (FNMA) mortgage-backed securities; Small Business Administration loans; loans guaranteed by the Farmers Home Loan Administration; Federal Housing Authority insured multi-family loans; real estate mortgage investment conduit (REMIC) and non-REMIC collateralized mortgage obligations, including residual interests and other derivative mortgage-backed securities and products. The Company also trades real estate mortgage loans originated by unaffiliated mortgage lenders, both on a securitized and non-securitized basis. The Company acts as underwriter and placement agent in transactions involving rated and non-rated mortgage-related securities issued by affiliated and unaffiliated parties. The Company enters into significant commitments such as forward contracts on GNMA, FNMA, and FHLMC securities, and on other rated and non-rated mortgage-related securities. Certain rated and non-rated mortgage-related securities are considered to be liquid, while other such securities and non-securitized mortgage loans are considered to be less readily marketable.

The Company trades GNMA, FNMA and FHLMC to be announced securities (i.e., securities having a stated coupon and the original term to maturity, although the issuer and/or the specific pool of mortgage loans is not known at the time of the transaction). The Company buys and sells such securities for its own account in transactions with institutional and individual customers, as well as with other dealers.

The Company, through various special purpose subsidiaries, purchases, originates, sells and services entire loan portfolios of varying quality. These portfolios are generally purchased from financial institutions and other secondary mortgage-market sellers. Prior to bidding on a portfolio of loans, an analysis of the portfolio is undertaken by experienced mortgage-loan underwriters. Upon acquisition of a loan portfolio, the loans are classified as either investment-grade or non-investment-grade. Loan collection is emphasized for the non-investment-grade segment of the loan portfolio. A collection department employs a staff of workout specialists and loan counselors who assist delinquent borrowers. If collection efforts are unsuccessful, the foreclosure group will commence and monitor the foreclosure process until either the borrower makes the loan current, or the property securing the loan is foreclosed or otherwise acquired. The portfolio may include real estate that has been foreclosed or was in the process of foreclosure at the time of its acquisition. The foreclosure group maintains and markets properties through regional real estate brokers. Investment-grade mortgage loans are sold to other institutional investors in either securitized or non-securitized form. Moreover, special purpose vehicles issue REMIC and non-REMIC collateralized mortgage obligations directly or through trusts that are established for this purpose.

The Company also operates a commercial mortgage conduit that originates and accumulates commercial mortgage loans for the purpose of securitization. After receipt of loan applications, extensive credit underwriting reviews are conducted. After completing pricing analysis and successful negotiations, the loan will close and be included in an ensuing securitization.

Asset-Backed Securities. The Company acts as underwriter and placement agent with respect to investment-grade and non-investment-grade asset-backed securities issued by affiliates as well as unaffiliated third parties. These asset-backed securities include: securities backed by consumer automobile receivables originated by the captive finance subsidiaries of automobile manufacturers, commercial banks and finance companies; credit card receivables and home-equity lines of credit or second mortgages. The Company also trades and is a market-maker in these asset-backed securities. While there are ready markets for the investment-grade asset-backed securities described above, non-investment-grade securities and related varieties thereof may lack liquidity.

Municipal Securities and Related Products. The Company is a dealer in tax-exempt and taxable municipal securities and instruments including: general obligation and revenue bonds; notes; leases; and variable-rate obligations issued by state and local governments and authorities, as well as not-for-profit institutions. The Company is active as a managing underwriter of negotiated and competitive new security issuances and, on a select basis, provides financial advisory services. The Company makes markets and takes positions in a broad spectrum of long-term and short-term municipal securities and derivative contracts, mainly to facilitate transactions with institutional and individual customers, as well as other dealers. As agent for issuers, the Company earns fees by remarketing short-term debt instruments to investors in the variable rate demand and auction rate bond market. The Company offers a variety of derivative products to issuers to assist them in reducing their borrowing costs, maximizing investment returns and managing cash flows and balance sheets, including but not limited to interest rate swaps, caps, floors, options and forward delivery, and debt service reserve and debt service deposit agreements. The Company periodically uses municipal and treasury bonds, futures and interest rate swaps to hedge its cash-market bond inventory. In addition, the Company maintains a hedged portfolio of high quality municipal securities which are remarketed as short-term securities in order to generate arbitrage profits.

Derivatives. The Company offers to institutional customers, and trades for its own account, a variety of exchange-traded and OTC derivative products, including fixed income, credit and equity derivatives. These products are transacted, as principal, with customers for hedging (credit, currency, interest rate or market), risk management, asset/liability management, investment, financing and other purposes. These transactions are in the form of swaps, options, swaptions, asset swaps and structured notes, as well as more complex, structured trades which are customized to meet customers specific needs. Derivatives enable customers to build tailor-made risk/return profiles, to customize transaction terms, to develop packaged solutions to a problem, to implement trades that otherwise could not be executed and to transact business with standardized documentation. The Company also enters into derivative transactions for various purposes, including to manage the risks to which the Company is exposed in its various businesses and through its funding activities. The Company manages its market and counterparty risks arising from derivatives activities in a manner consistent with its overall risk management policies. The Company has 24 hours a day capabilities with personnel based in New York, Chicago, London, Hong Kong, Tokyo, Singapore and Dublin.

Corporate and Sovereign Fixed Income. The Company acts as a dealer in corporate and sovereign fixed income securities as well as preferred stocks in New York, London and Tokyo. The Company buys and sells these securities for its own account in principal transactions with institutional and individual customers, as well as other dealers. The Company conducts trading in the full spectrum of dollar and non-dollar debt securities. The Company offers hedging and arbitrage services to domestic and foreign institutional and individual customers utilizing financial futures and other instruments. Moreover, the Company offers quantitative, strategic and research services relating to fixed income securities to its domestic and international clients. The Company participates in the trading of investment-grade and non-investment-grade corporate debt securities, commercial loans and sovereign and sovereign agency securities.

Foreign Exchange. The Company acts as a dealer in foreign exchange in New York and London. The Company conducts trading in major and minor currencies for spot or forward settlement, over-the-counter foreign exchange options and structured products, and listed foreign exchange futures and options on futures. The Company trades OTC contracts, on a principal basis, with domestic and international clients, as well as other dealers. The Company offers research and assists clients to meet their specific risk management objectives. Additionally, the Company enters into foreign exchange contracts to manage the currency risk or funding requirements of its various businesses.

Fixed Income Research. The Company is a leader in the distribution, trading and underwriting of corporate, government, high yield, emerging markets, municipal debt and mortgage-backed and asset-backed securities. Through objective and comprehensive analysis, the Fixed Income Research Department helps our businesses and clients position themselves strategically in global fixed income markets. Fixed Income Research Department produces a wide range of comprehensive publications, as well as leading data and analytics tools, which are available to investors throughout the world. This department also creates portfolio and trading ideas for investors based on valuations, analytics and market conditions.

Fixed Income Research is comprised of economists, industry analysts and strategists covering the full range of research disciplines: quantitative, fundamental, economic, strategic, credit portfolio, relative value and market-specific analysis. Representative of the Company s commitment to offering a broad range of research products, Fixed Income Research is comprised of the following units located in New York, London and Singapore:

(i) *Financial Analytics and Structured Transactions Group (F.A.S.T.)* is comprised of the Rates and Structured Products Research groups. F.A.S.T is a center of expertise for the creation and analysis of fixed income and derivative securities worldwide. F.A.S.T. uses innovative solutions that employ state-of-the-art analytics and technology to help the Company and its clients successfully meet individual business objectives. F.A.S.T. is a global resource for financial engineering and securitization capabilities, fixed income portfolio management and analytical systems, investment research, trading technology and general financial expertise. A strategic partner for the Company s international trading desks, risk management areas and sales force, F.A.S.T. also serves the Company s external clients. In addition to formulating and executing customized strategic investment and trading solutions, F.A.S.T. develops the tools and recommendations necessary to quantify relevant risks and evaluate portfolios and securities. F.A.S.T. s resources are used to create and model new types of securities, affording clients the unique perspective of both issuer and investor.

(ii) *High Grade Research* offers comprehensive coverage on approximately 16 industries and over 400 credit names whose securities are rated as investment-grade by the leading credit rating agencies. Through focus on the credit quality of individual issuers and macroeconomic factors, High Grade Research offers detailed analysis and expertise to investors in investment grade securities.

(iii) *High Yield Research* offers comprehensive coverage on approximately 20 industries and over 200 credit names whose securities do not qualify as investment-grade by the leading credit rating agencies. High Yield Research analyzes the risks, technical metrics, and fundamentals that investors need to develop their high yield portfolios.

(iv) *Emerging Markets Research* covers sovereign and corporate issues across Latin America, Central America and the Caribbean, Asia, the Middle East, Eastern Europe, and Africa. Emerging Markets Research focuses on macroeconomic factors, changes in US and global interest rates, investment fundamentals, as well as the political, economic and fiscal environments of issuers, to give investors a unique perspective into emerging markets fixed income securities.

(v) *Municipal Research* focuses on sectors, trends, and issuer-specific analysis of securities issued by states, cities, counties and other governmental entities. Municipal Research provides investors with detailed information and analysis on credit ratings and bond characteristics for the full range of municipal securities.

Investment Banking

The Company is a major global investment banking firm providing a full range of capital formation and advisory services to a broad spectrum of clients. The Company manages and participates in public offerings and arranges the private placement of debt and equity securities directly with institutional investors. The Company provides advisory services to clients on a wide range of financial matters and assists with mergers, acquisitions, leveraged buyouts, divestitures, corporate reorganizations and recapitalizations.

The Company s strategy is to concentrate a major portion of its corporate finance business development efforts within those industries in which the Company has established a leadership position in providing investment banking services. Industry specialty groups include media and entertainment, health care, financial institutions, industrial, technology and telecommunications. This list is not exclusive but rather reflects the areas where the Company believes its knowledge and expertise are strongest. The Company also has a group that focuses on financial sponsors. These groups are responsible for initiating, developing and maintaining client relationships and for executing transactions involving these clients.

In addition to being structured according to distinct industry groups, the Company has a number of professionals who specialize in specific types of transactions. These include mergers and acquisitions (M&A), equity offerings, high yield securities, leveraged and syndicated bank loans, leveraged acquisitions and other transaction specialties.

Mergers and Acquisitions. The Company provides strategic advisory services on a broad range of financial matters, including mergers and acquisitions, restructurings, split-offs and spin-offs, takeover defenses and other strategic advice.

Equity Offerings. The equity capital markets group focuses on providing financing for issuers of equity and convertible equity securities in the public markets. The group assists in the origination and is responsible for the structuring and execution of transactions for a broad range of clients.

High Yield Securities. The high yield securities group focuses on providing financing in the public and private capital markets. The group is responsible for originating, structuring and executing high yield transactions across a wide range of companies and industries, as well as managing client relationships with both high yield corporate issuers and financial sponsors of leveraged transactions.

Leveraged Loan Origination and Syndication. This area of the Company integrates the origination, structuring, underwriting, distribution and trading of loans. Such loans include both funded as well as committed investment-grade and non-investment-grade loans.

Leveraged Acquisitions. The Company makes investments as principal in leveraged acquisitions and in leveraged buy-out funds as a limited partner. The Company s investments generally take the form of either common or preferred stock or warrants. Equity securities purchased in these transactions generally are held for appreciation and are not readily marketable.

Commercial Real Estate. The Company is engaged in a variety of real estate activities on a nationwide basis. It provides comprehensive real estate-related investment banking, capital markets and financial advisory services.

Merchant Banking. Bear Stearns Merchant Banking, the private equity affiliate of the Company, invests private equity capital in compelling leveraged buyouts, recapitalizations and growth capital opportunities in a broad range of industries.

Emerging Markets

The Company provides financial services in various emerging markets worldwide including: securities brokerage, equity and fixed income trading and sales, and securities research, in addition to offering a full range of investment banking, capital formation and advisory services. As part of these activities, the Company manages and participates in public offerings and arranges the private placement of debt and equity securities with institutional investors. The markets currently covered by the Company include Latin America, Asia and Eastern Europe.

Global Clearing Services

Global Clearing Services provides securities clearing and custody, financing, securities lending, trade execution and technology solutions for hedge funds, broker-dealers and registered investment advisors.

For start-up and established hedge funds worldwide, Global Clearing Services is a leader in providing comprehensive prime brokerage , which includes securities clearing, advanced web-based portfolio reporting, enhanced leverage programs, term financing, securities lending and cash management.

For broker-dealers conducting retail, institutional and money management activities the Company provides fully disclosed correspondent securities clearing services . The Company s advanced proprietary technology, combined with comprehensive retail products, integrated prime brokerage, operations expertise and exceptional service have enabled the Company to maintain its industry leadership for many years.

For registered investment advisors whose services include asset management, leverage and active trading, the Company provides a combination of trade execution, web-based portfolio reporting for their investors and comprehensive service and support.

The Company derives revenues from commissions and service charges related to clearing and execution activities and from interest income on margin financing, client short selling activity, and uninvested balances. The Company extends margin loans directly to correspondents to finance proprietary activity.

The financial responsibilities arising from the Company s clearing relationships are allocated in accordance with agreements with correspondents. To the extent that the correspondent has available resources, the Company is protected against claims by customers of the correspondent when the correspondent has been allocated responsibility for an event giving rise to a claim. However, if the correspondent is unable to meet its obligations, dissatisfied customers may attempt to seek recovery from the Company.

Securities transactions are effected for customers on either a cash or margin basis. In a margin transaction, the Company extends credit to a customer for a portion of the purchase price of the security. Such credit is collateralized by securities in the customer s accounts in accordance with regulatory and internal requirements. The Company receives income from interest charged on such loans at a rate that is primarily based upon the Federal Funds Rate, Bear Stearns Base Lending Rate, or the London Inter-Bank Offered Rate (LIBOR).

The Company borrows securities from banks and other broker-dealers to facilitate customer and proprietary short selling activity, and lends securities to broker-dealers and other trading entities to cover short sales and to complete transactions that require delivery of securities by settlement date.

Futures

The Company, through BSSC and other subsidiaries, provides, directly or through third-party brokers, futures commission merchant services for customers and other Bear Stearns affiliates who trade contracts in futures on financial instruments and physical commodities, including options on futures. Exchange-traded futures and options derive their values from the values of the underlying selected stock indices, individual equity securities, fixed income securities, currencies, agricultural and energy products and precious metals.

Domestic futures and options trading is subject to extensive regulation by the Commodity Futures Trading Commission (CFTC), pursuant to the Commodity Exchange Act and the Commodity Futures Trading Commission Act of 1974. International futures and options trading activities are subject to regulation by the respective regulatory authorities in the locations where futures exchanges reside, including the FSA in the United Kingdom.

Margin requirements (good faith deposits) covering substantially all transactions in futures and options contracts are subject to each particular exchange s requirements in addition to other regulations. In the US, the Company, through BSSC and other subsidiaries, is a clearing member of the Chicago Board of Trade, the Chicago Mercantile Exchange, the New York Mercantile Exchange and other principal futures exchanges. In the United Kingdom, the Company through BSIL is a member of the International Petroleum Exchange (IPE), Euronext Liffe (LIFFE) and the European Derivatives Exchange (EDX). BSIL also has non-clearing memberships with Euronext Paris, Euronext Amsterdam and Eurex AG Frankfurt. In Japan, memberships are held by the Company through Bear Stearns (Japan), Limited (BSJL) with the Tokyo Stock Exchange, Inc. (TSE), the Osaka Securities Exchange Co., Ltd (OSE) and the Tokyo International Financial Futures Exchange (TIFFE).

PCS

PCS provides high-net-worth individuals with an institutional level of service, including access to the Company s resources and professionals. PCS has approximately 500 account executives in its principal office, six regional offices, three satellite offices and two international offices.

Asset Management

The Company s Asset Management Department manages equity, fixed income and alternative assets for some of the leading corporate pension plans, public systems, endowments, foundations, multi-employer plans, insurance companies, corporations, families and high-net-worth individuals in the US and abroad. With $41.9 billion in assets under management as of November 30, 2005, clients benefit from the asset management group s ability to leverage the Company s extensive resources and proven skill at turning innovative ideas into rewarding investment opportunities. Institutional and high-net-worth products span a broad spectrum of equity strategies including large cap, small cap, systematic, core and value equity; fixed income strategies including cash and enhanced cash management, short-term, intermediate, core, high yield and leveraged loans; and alternative investment strategies including various equity and fixed income hedge funds, a fund of proprietary hedge funds, private equity funds of funds, venture capital and structured products.

Administration and Operations

Administration and operations personnel are responsible for the human resources, legal and compliance areas; for processing of securities transactions; receipt, identification and delivery of funds and securities; internal financial controls; accounting functions; regulatory and financial reporting; office services; the custody of customer securities; the overseeing of margin accounts of the Company and correspondent organizations as well as other functions. The processing, settlement and accounting for transactions for the Company, correspondent organizations and the customers of correspondent organizations are handled by employees located in offices in New York, New Jersey and, to a lesser extent, the Company s offices worldwide.

The Company executes transactions globally on listed exchanges and in the OTC markets to facilitate customer and proprietary trading activities. The Company settles all of its domestic and international transactions (i.e., delivery of securities sold, receipt of securities purchased and transfer of related funds) through its own facilities, unaffiliated agent banks, other broker-dealers and through memberships in various clearing organizations.

International

Outside the US, the Company, through its international subsidiaries, provides various services including investment banking, securities and derivatives trading and brokerage and clearing activities to corporations, governments, institutions and individual clients throughout the world. These international subsidiaries of the Company have memberships on various foreign securities and futures exchanges.

BSIL, based in London, is a member of a number of European exchanges such as Eurex Deutschland (EUREX), the IPE, LIFFE, Euronext Paris, Euronext Amsterdam, and London Metals Exchange (LME). BSIL s capabilities include investment banking, institutional equities and fixed income sales, trading and research, derivatives, financial futures, foreign exchange, private client services and global clearing.

Bear Stearns International Trading Limited (BSIT) is also based in London and its principal activity is to act as a securities dealer making markets in equities.

BSJL, based in Tokyo, serves the diverse needs of corporations, financial institutions and government agencies by offering a range of international fixed income and equity products as well as listed futures. BSJL also offers a range of derivative products within Japan with special focus on fixed income, credit and equity derivatives. Asset-backed securitization, mergers and acquisitions, corporate finance and restructuring services are also available for local and cross-border business.

Bear Stearns Asia Limited (BSAL), based in Hong Kong, is the Company s primary operating entity in the Asia-Pacific region, excluding Japan. BSAL provides clients with international equity sales, trading and research services. In addition, BSAL is a major center within the Company s global fixed income, credit and equity-related derivatives businesses. BSAL also has investment banking capabilities to serve the growing needs of clients in Asia.

Bear Stearns Singapore Pte. Limited (BSSP) provides sales, execution and research services on fixed income securities to institutional investors in Asia.

BSB, based in Dublin, allows the Company s existing and prospective clients the opportunity of dealing with a banking counterparty. BSB also serves as a platform from which the Company directs some of its international banking activities, gaining easier access to worldwide markets and thereby expanding its capacity to increase its client base and product range. BSB engages in capital market activities with particular focus on the trading and sales of OTC interest rate derivative products. BSB also provides custody and trustee services to the growing number of alternative investment funds domiciled in Ireland and in other offshore jurisdictions.

(d) *Competition*

The Company encounters intense competition in all aspects of the securities business, particularly underwriting, trading and advisory services and competes directly with other securities firms both domestic and foreign many having substantially greater capital and resources and offering a wider range of financial services than does the Company. The Company s competitors include other brokers and dealers, commercial banks, investment banking firms, investment advisors, mutual funds, hedge funds, private equity funds and insurance companies

The Company believes that the principal factors affecting competition involve the caliber and abilities of professional personnel, the relative price of the service and products being offered, the ability to assist with financing arrangements and the quality of service.

Over time there has been substantial consolidation and convergence as institutions involved in a broad range of financial services industries have either ceased operations or have been acquired by or merged into other firms. This has resulted in competitors gaining greater capital, geographic reach and other resources, such as the ability to offer a wider range of products and services.

(e) *Regulatory and Compliance Factors Affecting the Company and the Securities Industry*

Legal: Firms in the financial services industry have been operating in a difficult regulatory environment. The industry has experienced increased scrutiny from a variety of regulators, including the SEC, NYSE, NASD and state attorneys general. Penalties and fines sought by regulatory authorities have increased substantially over the last several years.

Substantial legal liability or significant regulatory action against Bear Stearns could have material adverse financial effects or cause significant reputational harm to Bear Stearns, which in turn could seriously harm our business prospects. We face significant legal risks in our businesses, and the volume of claims and amount of damages and penalties claimed in litigation and regulatory proceedings against financial institutions have been increasing.

Bear Stearns, as a participant in the financial services industry, is subject to extensive regulation in jurisdictions in which we conduct business. Bear Stearns from time to time is the subject of inquires and investigations by regulatory agencies. As a result, among other things, we could be fined, prohibited from engaging in some of our business activities or subject to limitations or conditions on our business activities. New laws or regulations or changes in enforcement of existing laws or regulations applicable to our clients may also adversely affect our businesses.

In addition, the SEC and other federal and state regulators have increased their scrutiny of complex, structured finance transactions and have brought enforcement actions against a number of financial institutions in connection with such transactions. In some of the enforcement actions, clients of the financial institutions allegedly engaged in accounting, disclosure or other violations of the securities laws, and the financial institutions allegedly facilitated these improprieties by entering into transactions with the clients. We seek to create innovative solutions to address our clients needs, and we have entered into, and continue to enter into, structured transactions with clients. While we have policies and procedures in place that are intended to ensure that the structured transactions we enter into are appropriately reviewed and comply with applicable laws and regulations, it is possible that certain of these transactions could give rise to litigation or enforcement actions. It is possible that the heightened regulatory scrutiny of, and litigation in connection with, structured finance transactions will make our clients less willing to enter into these transactions, and will adversely affect our business in this area.

There have been a number of highly publicized cases involving fraud or other misconduct by employees in the financial services industry in recent years, and we run the risk that employee misconduct could occur. It is not always possible to deter or prevent employee misconduct and the precautions we take to prevent and detect this activity may not be effective in all cases.

On occasion, the Company and its subsidiaries have been subject to investigations and proceedings, and sanctions and fines have been imposed for infractions of various regulations, none of which, to date, has had a material adverse effect on the Company or its business. Settlements of regulatory matters may adversely affect business areas that are the subject of such settlements. As a general matter, regulatory settlements do not resolve related current and/or future civil litigations.

Regulation: The securities industry in the US is subject to extensive regulation under both federal and state laws. Moreover, Bear Stearns is registered as an investment adviser with the SEC. Much of the regulation of broker-dealers has been delegated to self-regulatory organizations, principally the NASD, the Municipal Securities Rulemaking Board, and national securities exchanges such as the NYSE, which has been designated by the SEC as the primary regulator of certain of the Company s subsidiaries, including Bear Stearns and BSSC. These self-regulatory organizations (i) adopt rules, subject to approval by the SEC, that govern the industry and (ii) conduct periodic examinations of the operations of the Company s broker-dealer subsidiaries. Securities firms are also subject to regulation by state securities administrators in those states where they conduct business.

US broker-dealers are subject to rules and regulations that cover all aspects of the securities business including: sales methods; trade practices; use and safekeeping of customer funds and securities; capital structures; recordkeeping; the preparation of research; the extension of credit and the conduct of officers and employees. Much of this regulation is embodied in the Securities Exchange Act of 1934 and rules promulgated thereunder, as well as the rules of self-regulatory organizations such as the NYSE and NASD. The types of regulations to which investment advisers are subject also are extensive and include: recordkeeping; fee arrangements; client disclosure; custody of customer assets; and the conduct of officers and employees. Much of this regulation is embodied in the Investment Advisers Act of 1940 and rules promulgated thereunder. The mode of operation and profitability of broker-dealers or investment advisers may be directly affected by new legislation, changes in rules promulgated by the SEC and self-regulatory organizations and changes in the interpretation or enforcement of existing laws and rules. The SEC, self-regulatory organizations and state securities commissions may conduct administrative proceedings that can result in censures, fines, the issuance of cease-and-desist orders and the suspension or expulsion of a broker-dealer or an investment adviser, its officers or employees. The principal purpose of regulation and discipline of broker-dealers and investment advisers is the protection of customers and the securities markets, rather than the protection of creditors and stockholders of broker-dealers or investment advisers.

The Market Reform Act of 1990 (the Market Reform Act) was adopted to strengthen the SEC s regulatory oversight of the national securities markets and increase the efficacy and stability of such markets by, among other things: (i) providing the SEC with discretion to halt securities trading on any national exchange for the protection of investors; (ii) requiring broker-dealers and other registrants to regularly provide information to the SEC regarding holding companies and other affiliated entities whose activities can impact their financial condition; (iii) requiring broker-dealers and other registrants who execute large-trade orders to provide information to the SEC regarding such transactions; and (iv) allowing the SEC to prosecute market participants who violate SEC rules and regulations designed to maintain fair and orderly markets. The SEC has adopted the Risk Assessment Reporting Requirements for Brokers and Dealers (the Risk Assessment Rules) to implement the provisions of the Market Reform Act. The Risk Assessment Rules require that broker-dealers: (i) have an organizational chart; (ii) maintain risk management procedures or standards for monitoring and controlling risks; (iii) maintain and preserve records and other information; and (iv) file quarterly reports covering the risk management procedures and the financial and securities activities of the holding companies of broker-dealers, or broker-dealer affiliates or subsidiaries that are reasonably likely to have a material impact on the financial and operational condition of the broker-dealer.

The Insider Trading and Securities Fraud Enforcement Act of 1988 was adopted to strengthen the SEC s ability to deter, detect and punish insider trading by, among other things: (i) increasing civil penalties that can be assessed against controlling persons who purposefully or recklessly fail to take adequate measures to prevent insider trading; (ii) allowing the SEC to provide cash rewards to individuals who provide evidence of insider trading; (iii) affirming the government s ability to obtain criminal sanctions against those found guilty of insider trading; and (iv) requiring broker-dealers and investment advisers to establish and enforce written procedures reasonably designed to prevent the misuse of material, nonpublic information.

The Government Securities Act of 1986 was adopted to decrease volatility and increase investor confidence and liquidity in the government securities market by creating a coordinated and comprehensive regulatory structure for the market where none had previously existed. In particular, the Government Securities Act: (i) requires broker-dealers solely involved in government securities transactions to register with the SEC; (ii) allows the Secretary of the Treasury to adopt rules regarding the custody, use, transfer and control of government securities; and (iii) bestows upon the SEC authority to enforce such rules as to broker-dealers and other SEC registrants.

The futures industry in the US is subject to regulation under the Commodity Exchange Act, as amended. The CFTC is the federal agency charged with the administration of the Commodity Exchange Act and the regulations thereunder. Bear Stearns and BSSC are registered with the CFTC as futures commission merchants and are subject to regulation as such by the CFTC and various domestic boards of trade and other futures exchanges. Bear Stearns and BSSC s futures business is also regulated by the NFA, a not-for-profit membership organization, which has been designated a registered futures association by the CFTC.

As registered broker-dealers and member firms of the NYSE, both Bear Stearns and BSSC are subject to the Net Capital Rule (Rule 15c3-1) (the Net Capital Rule) under the Exchange Act, which has been adopted through incorporation by reference in NYSE Rule 325. The Net Capital Rule, which specifies minimum net capital requirements for registered broker-dealers, is designed to measure the general financial integrity and liquidity of broker-dealers and requires that at least a minimal portion of a broker-dealer s assets be kept in relatively liquid form.

In June 2004, the SEC adopted rule amendments to Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities (Rule 34-49830) that allow investment banks to voluntarily submit to be regulated by the SEC on a global consolidated basis. These regulations (referred to as CSE) were in response to what is known as the Financial Conglomerates Directive (2002/87/EC) of the European Parliament, which served to compel globally active institutions doing business in Europe to be regulated on a global consolidated basis. During fiscal 2005, the Company applied to the SEC to be regulated under this new CSE regime. The application filed with the SEC by Bear Stearns, the Company s principal U.S. broker-dealer, under the net capital rule amendments, was approved in November 2005. As a result, effective December 1, 2005, Bear Stearns will use alternative methods of computing market and derivative-related credit risk, and, as a condition of using these methods, the Company has consented to consolidated supervision by the SEC. The new framework will be a notable change in the Company s regulation, as activities which are currently transacted outside of SEC regulated entities will come under the scope of certain SEC regulations and capital adequacy oversight. In particular, the Company will: compute allowable capital and allowances for market, credit and operational risk on a consolidated basis in accordance with standards prescribed in Appendix G to the Net Capital Rules; permit the SEC to examine the books and records of the Parent Company and any affiliate that does not have a principal regulator; and adopt various additional SEC reporting, record-keeping and notification requirements. Additionally, the Company must comply with the provisions of Rule 15c3-4 of the Exchange Act with respect to a group-wide internal risk management control system in the affiliate group as if it were an OTC derivative dealer, subject to certain limitations. The Company is now deemed a CSE and is in compliance with regulatory capital requirements.

Bear Stearns and BSSC are also subject to the net capital requirements of the CFTC and various futures exchanges, which generally require that Bear Stearns and BSSC maintain a minimum net capital equal to the greater of the alternative net capital requirement provided for under the Exchange Act or 8% of the total risk maintenance margin requirements for positions carried in customer accounts plus 4% of the total risk maintenance margin requirements for positions carried in non-customer accounts, in each case as defined in Rule 1.17 of the CFTC.

Compliance with the Net Capital Rule could limit those operations of Bear Stearns and/or BSSC that require significant capital usage, such as underwriting, trading and the financing of customer margin account debit balances. The Net Capital Rule could also restrict the Company s ability to withdraw capital from Bear Stearns or BSSC, which in turn could limit the Company s ability to pay dividends, pay interest, repay debt, or redeem or purchase shares of its outstanding capital stock. Additional information regarding net capital requirements is set forth under Item 8. Financial Statements and Supplementary Data in Note 16 of Notes to Consolidated Financial Statements entitled Regulatory Requirements .

The activities of the Company s bank and trust company subsidiary, CTC, are regulated by the New Jersey Department of Banking and Insurance and the FDIC. FDIC regulations require certain disclosures in connection with joint advertising or promotional activities conducted by Bear Stearns and CTC. Such regulations also restrict certain activities of CTC in connection with the securities business of Bear Stearns. The Competitive Equality in Banking Act of 1987, as amended, limits the use of overdrafts at Federal Reserve Banks on behalf of affiliates.

Non-US Regulation: BSIL is a member of the following: Borsa Italiana, Casa di Compensazione & Garanzia (CC&G), Clearstream Banking Frankfurt (CBF), EDX London Limited, EUREX, Euronext, Deutsche Borse, The Futures Industry Association (FIA), The Futures & Options Association (FOA), IPE, International Securities Markets Association (ISMA), LCH Clearnet Limited (LCH), Mercato Telematico all Ingrosso dei Titoli de Stato (MTS), SegaInterSettle AG (SIS), Stockholmsborsen AB and Virt-x. Another London subsidiary, BSIT, is a member of the London Stock Exchange (LSE), CREST (The Settlement Network) and a shareholder in Euroclear Plc. Both BSIL and BSIT are authorized and regulated in the United Kingdom by the FSA, pursuant to The Financial Services and Markets Act 2000. FSA regulates all aspects of the financial services industry in the United Kingdom and its Rules cover (inter alia): senior management responsibilities, regulatory capital, sales and trading practices, safekeeping of customer funds, record keeping, registration standards for individuals and reporting to customers.

BSJL is licensed with and regulated by the Financial Services Agency of Japan. BSJL is a limited trade participant to the TSE and the OSE and has a membership on the TIFFE. Bear Stearns Hong Kong Limited is registered as a Commodities Dealer with the Securities and Futures Commission (SFC) in Hong Kong and its main business consists of sales of US futures products to corporate and retail customers in Hong Kong. BSAL is registered as a Securities Dealer with the SFC in Hong Kong and is a participant (i.e. member) of the Hong Kong Exchange Limited. BSSP has a Capital Market Service license to conduct regulated activities in Dealing in Securities & Advising on Corporate Finance. BSSP provides sales, execution and research services on fixed income securities to institutional investors in Asia.

BSB is an Ireland-based bank which was incorporated as a limited liability company on November 27, 1995 and then re-registered on October 15, 1996 as a public company. BSB was granted a banking license on April 10, 1997 under the Irish Central Bank Act, 1971 and is regulated by the Irish Financial Services Regulatory Authority (formerly the Central Bank of Ireland), which is the principal regulator of banks in Ireland.

Insurance: Bear Stearns and BSSC are members of the Securities Investor Protection Corporation (SIPC), which provides protection for customer accounts held by these entities of up to $500,000 for each customer, subject to a limitation of $100,000 for cash balance claims in the event of the liquidation of a broker-dealer. In addition, all BSSC security accounts are protected by an excess securities bond issued by the Customer Asset Protection Company, up to the amount of their total net equity (both cash and securities) in excess of the underlying SIPC protection.

Item 1A. Risk Factors.

In addition to the other information contained in this Form 10-K and the exhibits hereto, the following risk factors should be considered carefully in evaluating the Company s business. A discussion of the policies and procedures used to identify, assess and manage certain risks is set forth under the caption Risk Management in the Annual Report, which is incorporated herein by reference to Exhibit No. 13 of this report. The Company s business, financial condition, or results of operations could be materially adversely affected by any of these risks. Additional risks not presently known to the Company or that the Company currently deems immaterial may also adversely affect its business, financial condition, or results of operations.

Our businesses could be adversely affected by market fluctuations. Our businesses are materially affected by conditions in the financial markets and economic conditions generally, both in the United States and elsewhere around the world. In the event of a market downturn, our businesses could be adversely affected in many ways, including those described below. Our revenues are likely to decline in such circumstances and, if we were unable to reduce expenses at the same pace, our profit margins would erode. Even in the absence of a market downturn, we are exposed to substantial risk of loss due to market volatility.

Market fluctuations and volatility may cause us to incur significant losses in our trading and investment activities. We generally maintain large trading and investment positions in the fixed income, currency, commodity and equity markets. To the extent that we own assets, i.e., have long positions, in any of those markets, a downturn in those markets could result in losses from a decline in the value of those long positions. Conversely, to the extent that we have sold assets we do not own, i.e., have short positions, in any of those markets, an upturn in those markets could expose us to potentially unlimited losses as we attempt to cover our short positions by acquiring assets in a rising market. In addition, we maintain substantial trading positions that can be adversely affected by the level of volatility in the financial markets, i.e., the degree to which trading prices fluctuate over a particular period, in a particular market, regardless of market levels.

The Company s businesses may be adversely affected by fluctuations in interest rates, foreign exchange rates and equity prices. In connection with the Company s dealer and arbitrage activities, including market making in over-the-counter derivative contracts, the Company may be adversely affected by changes in the level or volatility of interest rates, mortgage prepayment speeds or the level and shape of the yield curve. In addition, when the Company buys or sells a foreign currency or a financial instrument denominated in a currency other than U.S. dollars, exposure exists from a net open currency position. Until the position is covered by selling or buying the equivalent amount of the same currency or by entering into a financing arrangement denominated in the same currency, the Company is exposed to a risk that the exchange rate may move against it. The Company is also exposed to equity price risk through making markets in equity securities, distressed debt, equity derivatives as well as specialist activities. The Company may be adversely affected by changes in the level or volatility of equity prices, which affect the value of equity securities or instruments that derive their value from a particular stock, a basket of stocks or a stock index.

Our investment banking revenues may decline in adverse market or economic conditions. Unfavorable financial or economic conditions would likely reduce the number and size of transactions in which we provide underwriting, mergers and acquisitions advisory and other services. Our investment banking revenues, in the form of financial advisory and underwriting fees, are directly related to the number and size of the transactions in which we participate and would therefore be adversely affected by a sustained market downturn. In particular, our results of operations would be adversely affected by a significant reduction in the number or size of mergers and acquisitions transactions.

We may generate lower revenues from commissions and asset management fees in a market downturn. A market downturn could lead to a decline in the volume of transactions that we execute for our customers and, therefore, to a decline in the revenues we receive from commissions and spreads. In addition, because the fees that we charge for managing our clients portfolios are in many cases based on the value of those portfolios, a market downturn that reduces the value of our clients portfolios or increases the amount of withdrawals would reduce the revenue we receive from our asset management business.

Our risk management policies and procedures may leave us exposed to unidentified or unanticipated risk. The policies and procedures we use to identify, assess and manage the risks we assume in conducting our businesses are set forth under the caption Risk Management in the Annual Report, which is incorporated herein by reference to Exhibit No. 13 of this report. We have devoted significant resources to develop our risk management policies and procedures and expect to continue to do so in the future. Nonetheless, our policies and procedures to identify, assess and manage risks may not be fully effective. Some of our methods of managing risk are based upon our use of observed historical market behavior. As a result, these methods may not predict future risk exposures, which could be significantly greater than the historical measures indicate. Other risk management methods depend upon evaluation of information regarding markets, clients or other matters that is publicly available or otherwise accessible by the Company. This information may not in all cases be accurate, complete, up-to-date or properly evaluated. Management of operational, legal and regulatory risk requires, among other things, policies and procedures to record properly and verify a large number of transactions and events, and these policies and procedures may not be fully effective.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition. Liquidity, i.e., ready access to funds, is essential to our businesses. Our sources of liquidity are set forth under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources in the Annual Report, which is incorporated herein by reference to Exhibit No. 13 of this report. An inability to raise money in the long-term or short-term debt markets, or to engage in repurchase agreements or securities lending, could have a substantial negative effect on our liquidity. Our access to debt in amounts adequate to finance our activities could be impaired by factors that affect the Company in particular or the financial services industry in general. For example, lenders could develop a negative perception of our long-term or short-term financial prospects if we incurred large trading losses, if the level of our business activity decreased due to a market downturn or if regulatory authorities took significant action against us. Our ability to borrow in the debt markets also could be impaired by factors that are not specific to the Company, such as a severe disruption of the financial markets or negative views about the prospects for the investment banking, securities or financial services industries generally.

A reduction in our credit ratings could adversely affect our liquidity and competitive position and increase our borrowing costs. The Company s access to external sources of financing, as well as the cost of that financing, is dependent on various factors and could be adversely affected by a deterioration of the Company s long- and short-term debt ratings, which are influenced by a number of factors. These include, but are not limited to: material changes in operating margins; earnings trends and volatility; the prudence of funding and liquidity management practices; financial leverage on an absolute basis or relative to peers; the composition of the balance sheet and/or capital structure; geographic and business diversification; and the Company s market share and competitive position in the business segments in which it operates. Material deterioration in any one or a combination of these factors could result in a downgrade of the Company s credit ratings, thus increasing the cost of and/or limiting the availability of unsecured financing. Additionally, a reduction in the Company s credit ratings could also trigger incremental collateral requirements, predominantly in the over-the-counter derivatives market.

We are exposed to risks resulting from non-performance by counterparties, customers, borrowers or debt security issuers. The Company is exposed to credit risk in its role as trading counterparty to dealers and customers, as direct lender, as holder of securities and as member of exchanges and clearing organizations. We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons. The policies and procedures we use to manage credit risk are set forth under the caption Risk Management Credit Risk in the Annual Report, which is incorporated herein by reference to Exhibit No. 13 of this report. There can be no assurances that these policies and procedures will effectively mitigate our exposure to credit risk.

Operational risks may disrupt our businesses, result in regulatory action against us or limit our growth. Operational risk is the potential for loss arising from inadequate or failed internal processes, people or systems, or from external events. This includes, but is not limited to, limitations in the Company s financial systems and controls, deficiencies in legal documentation, non-compliance with the execution of legal, regulatory and fiduciary responsibilities, deficiencies in technology and the risk of loss attributable to operational problems. Our businesses are highly dependent on our ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies, and the transactions we process have become increasingly complex. Consequently, we rely heavily on our financial, accounting and other data processing systems. If any of these systems do not operate properly or are disabled, we could suffer financial loss, a disruption of our businesses, liability to clients, regulatory intervention or reputational damage.

Litigation, governmental investigations and/or other legal proceedings could adversely affect the company s business. We and certain of our subsidiaries are involved in litigation, government investigations; and other legal proceedings that arise from time to time in the ordinary course of our business. Litigation is inherently unpredictable, and excessive verdicts do occur. Although we believe we have substantial defenses in these matters, we could in the future incur judgments or enter into settlements of claims that could have a material adverse effect on our results of operations in any particular period. See Item 3. Legal Proceedings. for a discussion of certain of the legal matters in which we are currently involved.

Extensive regulation of our businesses limits our activities and may subject us to significant penalties. The financial services industry is subject to extensive regulation. The Company is subject to regulation by governmental and self-regulatory organizations in the United States and in several other jurisdictions in which it operates around the world. These regulations often serve to limit our activities, including through net capital, customer protection and market conduct requirements. We face the risk of significant intervention by regulatory authorities, including extended investigation and surveillance activity, adoption of costly or restrictive new regulations and judicial or administrative proceedings that may result in substantial penalties. Non-compliance with legal and regulatory requirements could have a material adverse financial effect or cause significant reputational harm to the Company, which in turn could seriously harm our business prospects. See Item 1. Business Regulatory and Compliance Factors Affecting the Company and the Securities Industry for a further discussion of the regulatory environment in which we conduct our businesses.

The financial services industry is intensely competitive. The Company encounters intense competition in all aspects of the securities business, particularly underwriting, trading and advisory services and competes directly with other securities firms both domestic and foreign many having substantially greater capital and resources and offering a wider range of financial services than does the Company. The Company competes on the basis of a number of factors, including transaction execution, our products and services, innovation, reputation and price. We may be adversely affected if our current or potential customers and clients decide to use the financial services of our competitors instead of us.

Changes in business, political and/or economic conditions could have an adverse effect on the Company. Our future results could be adversely affected by changes in business, political and economic conditions, including the cost and availability of insurance, due to the threat of future terrorist activity in the U.S. and other parts of the world and related U.S. military action overseas.

Employee misconduct is difficult to detect and prevent and may have an adverse effect on our businesses. In recent years, there have been a number of highly publicized cases involving fraud or other misconduct by employees in the financial services industry, and we run the risk that employee misconduct could occur. It is not always possible to deter or prevent employee misconduct and the precautions we take to prevent and detect this activity may not be effective in all cases.

The inability to hire and retain qualified employees may adversely affect our business. Our performance is largely dependent on the talents and efforts of highly skilled individuals. There is intense competition in the financial services industry for qualified employees. In addition, we face increasing competition with businesses outside the financial services industry, such as hedge funds, private equity funds and venture capital funds, for the most highly skilled individuals. Our business could be adversely affected if we are unable to attract new employees and retain and motivate our existing employees.

Item 1B. Unresolved Staff Comments.

None

* * * * *

Certain statements contained in this discussion including (without limitation) certain matters discussed under Legal Proceedings in Part I, Item 3 of this report, Management s Discussion and Analysis of Financial Condition and Results of Operations incorporated by reference in Part II, Item 7 of this report, and Quantitative and Qualitative Disclosures about Market Risk incorporated by reference in Part II, Item 7A of this report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements concerning management s expectations, strategic objectives, business prospects, anticipated economic performance and financial condition and other similar matters are subject to risks and uncertainties, including those described in the prior paragraph, which could cause actual results to differ materially from those discussed in the forward-looking statements. Forward-looking statements speak only as of the date of the document in which they are made. The Company disclaims any obligation or undertaking to provide any updates or revisions to any forward-looking statement to reflect any change in the Company s expectations or any change in events, conditions or circumstances on which the forward-looking statement is based.

Item 2. Properties.

The Company s executive offices and principal administrative offices occupy approximately 1.1 million square feet at 383 Madison Avenue, New York, New York under an operating lease arrangement.

The lease arrangement expires on August 13, 2010. At the end of the lease, the Company may request a lease renewal. In the event the lease renewal cannot be negotiated, 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 being used to satisfy the lessor s debt obligation.

The Company leases approximately 291,000 square feet of office space at One MetroTech Center, Brooklyn, New York, through 2024 for its securities processing, accounting and clearance operations. The Company also leases approximately 3,000, 13,000, 59,000, 61,000 and 97,000 square feet of space at five locations in New York City expiring in 2010, 2007, 2009, 2011 and 2020, respectively. The Company s offices in

Atlanta, Bellevue, Boca Raton, Boston, Chicago, Clayton, Dallas, Denver, El Paso, Houston, Irving, King of Prussia, Lewisville, Los Angeles, Palm Beach, Palo Alto, Philadelphia, Princeton, San Francisco, San Juan, Scottsdale and Tampa occupy an aggregate of approximately 775,000 square feet, while its eleven international offices occupy a total of approximately 195,000 square feet under leases expiring on various dates through the year 2016.

The Company owns approximately 65 acres of land in Whippany, New Jersey, including four buildings comprising an aggregate of approximately 673,000 square feet. The Company is currently using the facilities on the property to house its data processing facility and other operations, disaster recovery, compliance, personnel and accounting functions. Approximately 141,000 square feet in one of the buildings is being leased to an unaffiliated third party under a 15-year operating lease expiring in 2019.

Item 3. Legal Proceedings.

In the normal course of business, the Company and its subsidiaries are named as defendants in various legal actions, including arbitrations, class actions and other litigation. Such actions include those arising out of the Company s or a subsidiary s activities as a broker and dealer, as an underwriter, investment banker, employer or arising out of alleged employee misconduct. 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 organizations regarding the Company s business. Certain of the foregoing could result in adverse judgments, settlements, fines, penalties 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 be ultimately 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, that the resolution of the following 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 Statement of Financial Accounting Standards No. 5, Accounting for Contingencies . The ultimate resolution may differ materially from the amounts reserved.

Fezanni, et al. v. Bear, Stearns & Co. Inc., et al.: On February 2, 1999, an action was commenced in the United States District Court for the Southern District of New York by eleven individuals or entities that allegedly purchased securities underwritten by A.R. Baron & Company, Inc. (Baron), a firm for which BSSC provided clearing services. The action named as defendants Bear Stearns, BSSC, a former officer of BSSC, thirteen former officers and employees of Baron, and 33 other individuals and entities that purportedly participated in alleged misconduct by Baron involving attempts to manipulate the market for securities it underwrote. On April 6, 2004, the district court granted motions to dismiss all causes of action that plaintiffs brought against Bear Stearns, BSSC, and the former officer of BSSC.

On or about September 23, 2004, the plaintiffs filed an amended complaint against Bear Stearns, BSSC, a former officer of BSSC and other individuals and entities, alleging that they participated in misconduct by Baron involving attempts to manipulate the market for certain securities underwritten by Baron. As a result of plaintiffs failure to seek the district court s leave prior to filing their amended complaint, the court subsequently mandated plaintiffs to formally move the court for permission to file an amended complaint. On March 1, 2005, the court granted in part and denied in part plaintiffs motion seeking permission to file an amended complaint. Plaintiffs amended complaint, which contains many of the same allegations as the original complaint, alleges that the Bear Stearns defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, committed common law fraud, aided and abetted fraud, and were part of a civil conspiracy to defraud in connection with providing clearing services and financing to Baron. The amended complaint seeks to recover compensatory damages of at least $8.3 million and punitive damages of $125 million from Bear Stearns and BSSC.

Bear Stearns and BSSC deny all allegations of wrongdoing asserted against them in the amended complaint and believe that they have substantial defenses to these claims.

McKesson HBOC, Inc.: The following matters arise out of a merger between McKesson Corporation (McKesson) and HBO & Company (HBOC) resulting in an entity called McKesson HBOC, Inc. (McKesson HBOC). Bear Stearns believes that it has substantial defenses to the claims in each of these matters.

(i) In re McKesson HBOC, Inc. Securities Litigation: Beginning on June 29, 1999, 53 purported class actions were commenced in the United States District Court for the Northern District of California. These actions were subsequently consolidated, and the plaintiffs proceeded to file a series of amended complaints. On February 15, 2002, plaintiffs filed a third amended consolidated complaint, which alleges that Bear Stearns violated Sections 10(b) and 14(a) of the Exchange Act in connection with allegedly false and misleading disclosures contained in a joint proxy statement/prospectus that was issued with respect to the McKesson/HBOC merger.

Plaintiffs purport to represent a class consisting of all persons who either (i) acquired publicly traded securities of HBOC between January 20, 1997 and January 12, 1999, or (ii) acquired publicly traded securities of McKesson or McKesson HBOC between October 18, 1998 and April 27, 1999, and who held McKesson securities on November 27, 1998 and January 22, 1999. Named defendants include McKesson HBOC, certain present and former directors and/or officers of McKesson HBOC, McKesson and/or HBOC, Bear Stearns and Arthur Andersen LLP. Compensatory damages in an unspecified amount are sought.

On January 6, 2003, the court granted Bear Stearns motion to dismiss the Section 10(b) claim asserted in the third amended complaint, and denied Bear Stearns motion to dismiss the Section 14(a) claim. On March 7, 2003, Bear Stearns filed an answer to the third amended complaint denying all allegations of wrongdoing and asserting affirmative defenses to the claims in the complaint. On January 12, 2005, McKesson HBOC announced that it had reached a settlement with the plaintiff class, which settlement required court approval. Bear Stearns engagement letter with McKesson in connection with the merger of McKesson and HBOC provides that McKesson cannot settle any litigation without Bear Stearns written consent unless McKesson obtains an unconditional written release for Bear Stearns and, under certain circumstances, is required to provide indemnification to Bear Stearns.

By Order dated May 23, 2005, the Court denied preliminary approval of the proposed settlement between McKesson HBOC and the plaintiff class. On July 12, 2005, the plaintiff and McKesson HBOC submitted a revised proposed settlement, purporting to address the issues identified by the Court in its order denying preliminary approval, to which Bear Stearns objected. The revised proposed settlement provides, among other things, that Bear Stearns rights under its engagement letter are preserved for future resolution. McKesson HBOC s claims in connection with the letter are also preserved. On September 8, 2005, the court granted preliminary approval of the revised proposed settlement. A hearing at which the court will consider objections to final approval of the settlement is scheduled for February, 24, 2006. Bear Stearns has objected to final approval on the ground that consummation of the settlement may deprive Bear Stearns of certain rights and remedies provided for in its engagement letter.

On December 8, 2005, Bear Stearns commenced a separate action in New York State Supreme Court, New York County, Bear Stearns v. McKesson Corp., asserting breach of contract and other claims against McKesson based on the engagement letter and seeking, among other things, declaratory relief and damages.

(ii) Merrill Lynch Fundamental Growth Fund, Inc., et al. v. McKesson HBOC, Inc., et al.: On or around March 19, 2002, an action was commenced against, among others, Bear Stearns in the Superior Court of the State of California, County of San Francisco, by two investment funds that acquired the common stock of McKesson HBOC between February 5 and March 12, 1999. On August 8, 2002, plaintiffs filed an amended complaint and thereafter a second and third amended complaint that did not name Bear Stearns as a defendant. On October 7, 2002, this action was consolidated with other litigation arising out of the merger between McKesson and HBOC.

On September 26, 2003, the court granted plaintiffs motion for leave to file a fourth amended complaint adding Bear Stearns as a defendant. Also named as defendants are McKesson HBOC, HBOC, certain present or former officers and/or directors of McKesson, HBOC and/or McKesson HBOC and Arthur Andersen. The complaint alleges, among other things, that Bear Stearns violated Section 25500 of the California Corporations Code and committed common law fraud and negligent misrepresentation in connection with allegedly false and misleading disclosure contained in a joint proxy statement/prospectus that was issued with respect to the McKesson/HBOC merger. Compensatory damages in an unspecified amount were sought. Bear Stearns filed an answer to the fourth amended complaint in which it denied all allegations of wrongdoing and asserted affirmative defenses to the claims in the complaint.

On October 28, 2005, the Merrill Lynch Fundamental Growth Fund s claims were dismissed with respect to Bear Stearns with prejudice. Bear Stearns did not make any payments in connection with the dismissal of the claims against it.

Helen Gredd, Chapter 11 Trustee for Manhattan Investment Fund Ltd. v. Bear, Stearns Securities Corp.: On April 24, 2001, an action was 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). BSSC is the sole defendant. The complaint alleges, among other things, that certain transfers of cash and securities to BSSC in connection with short sales of securities by MIFL in 1999 were fraudulent transfers made in violation of Sections 548 and 550 of the United States Bankruptcy Code and are recoverable by the Trustee. The Trustee also alleges that any claim that may be asserted by BSSC against MIFL should be equitably subordinated to the claims of other creditors pursuant to Sections 105 and 510 of the Bankruptcy Code. The Trustee seeks to recover in excess of $1.9 billion in connection with the allegedly fraudulent transfers to BSSC.

On March 21, 2002, the district court dismissed the trustee s claims seeking to recover allegedly fraudulent transfers in amounts exceeding $1.9 billion. The district court also remanded to the bankruptcy court the trustee s remaining claims, which seek to recover allegedly fraudulent transfers in the amount of $141.4 million and to equitably subordinate any claim that may be asserted by BSSC against MIFL to the claims of other creditors.

On October 17, 2002, BSSC filed an answer to the complaint in which it denied all allegations of wrongdoing and asserted affirmative defenses.

Sterling Foster & Co., Inc.: The following matters arise out of Bear Stearns role as clearing broker for Sterling Foster & Co., Inc. (Sterling Foster).

(i) Levitt, et al. v. Bear Stearns, et al.: On February 16, 1999, a purported class action was commenced in the United States District Court for the Southern District of New York on behalf of all persons who purchased ML Direct, Inc. common stock or warrants through Sterling Foster & Co., Inc. (Sterling Foster) between September 4, 1996 and December 31, 1996. Named as defendants are Bear Stearns and BSSC. The complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder and committed common law fraud in connection with providing clearing services to Sterling Foster with respect to certain transactions by customers of Sterling Foster in ML Direct common stock and warrants. Compensatory damages of $50 million and punitive damages of approximately $100 million are sought.

On April 6, 1999, this action was transferred by the Judicial Panel on Multi-District Litigation to the United States District Court for the Eastern District of New York.

On June 27, 2002, the court granted defendants motion and dismissed this action in its entirety. On August 1, 2002, plaintiff filed a notice of appeal from the district court order dismissing the complaint in this action. On August 13, 2003, the United States Court of Appeals for the Second Circuit reversed the district court order granting defendants motion to dismiss and remanded the action to the district court.

Bear Stearns and BSSC have denied all allegations of wrongdoing asserted against them in this litigation, and believe that they have substantial defenses to these claims.

(ii) Rogers v. Sterling Foster & Co., Inc.: On February 16, 1999, Bear Stearns, BSSC and an officer of BSSC were added as defendants in a purported class action pending in the United States District Court for the Eastern District of New York. The action is brought on behalf of a purported class consisting of all persons who purchased or otherwise acquired certain securities that were underwritten by Sterling Foster. Named as defendants, in addition to the Bear Stearns defendants set forth above, are Sterling Foster, seven individuals alleged to have had an employment relationship with, or exercised control over, Sterling Foster, six companies that issued securities underwritten by Sterling Foster, eight individuals who were directors, officers and/or employees of these issuers, and Bernstein & Wasserman LLP and two of its partners. The second amended complaint alleged, among other things, that the Bear Stearns defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder and Section 349 of the New York General Business Law and committed common law fraud in connection with providing clearing services to Sterling Foster. Compensatory damages in an unspecified amount were sought. On June 27, 2002, the court granted defendants motion to dismiss and dismissed the claims against Bear Stearns, BSSC, and the former officer of BSSC in their entirety.

On September 29, 2004, the court granted plaintiffs motion to vacate the June 27, 2002 dismissal and granted plaintiffs request to amend their complaint against Bear Stearns and BSSC with respect to two securities underwritten by Sterling Foster.

Bear Stearns and BSSC deny all allegations of wrongdoing asserted against them in this litigation and believe they have substantial defenses to the claims.

Enron Corp.: The following matters arise out of Bear Stearns business transactions with or relating to Enron Corp. (Enron).

(i) Purported Securities Actions: Bear Stearns and numerous other defendants had been named in certain actions commenced beginning on October 15, 2002 in the Superior Court of the State of California, state court in Iowa and the United States District Court for the Southern District of Texas brought by purchasers of securities issued by Osprey Trust, Osprey I, Inc., Enron and certain other entities related to Enron. The complaints generally alleged violations of the disclosure requirements of the federal securities laws and/or state law and common law claims, including fraud, and sought compensatory and/or punitive damages in unspecified amounts.

The parties to the actions pending in the Superior Court of the State of California and state court in Iowa, including Bear Stearns, have reached agreements to settle these actions and have jointly filed stipulations of dismissal for the settled actions with the respective California and Iowa state courts.

Bear Stearns denies all allegations of wrongdoing asserted against it in the litigation pending in the United States District Court for the Southern District of Texas and believes it has substantial defenses to these claims.

(ii) Enron Corp., et ano. v. Bear, Stearns International Ltd., et ano.: On November 25, 2003, BSIL and BSSC were named as defendants in an adversary proceeding commenced by Enron and Enron North America Corp. in the United States Bankruptcy Court for the Southern District of New York. Plaintiffs seek, inter alia, to recover payments, totaling approximately $26 million that were allegedly made to BSIL and BSSC during August 2001 in connection with an equity derivative contract between BSIL and Enron. According to the complaint, Enron s payments constituted (a) fraudulent transfers, under Section 548(a) of the United States Bankruptcy Code and under applicable state law and (b) an unlawful redemption of Enron common stock in violation of Oregon law. Enron seeks judgment (a) avoiding and setting aside Enron s August 2001 payments to BSIL and BSSC, (b) directing BSIL and BSSC to pay Enron approximately $26 million, plus prejudgment interest, (c) declaring that Enron s August 2001 payments violated Oregon law, (d) disallowing any claims by BSIL and BSSC in connection with Enron s bankruptcy proceedings until they have returned the August 2001 payments to Enron and (e) awarding Enron its reasonable attorneys fees and costs incurred in connection with the action.

By Order dated June 3, 2005, the bankruptcy court denied the motion to dismiss filed by BSIL and BSSC. On July 5, 2005, defendants filed a motion for leave to take an interlocutory appeal from the bankruptcy court s decision.

(iii) Enron Corp. v. International Finance Corp., et al.: On November 20, 2003, numerous parties, including Bear Stearns, were named as defendants in an adversary proceeding commenced by Enron in the United States Bankruptcy Court for the Southern District of New York. The complaint asserts, inter alia, that certain alleged payments by Enron during May 2001 in connection with the purchase from certain defendants of notes issued by ENA CLO I Trust, including a payment to Bear Stearns of approximately $34 million, constituted fraudulent transfers in violation of Section 548(a)(1)(B) of the United States Bankruptcy Code. As to Bear Stearns, Enron seeks an order (a) directing Bear Stearns to pay Enron approximately $34 million, plus prejudgment interest, (b) disallowing any claims by Bear Stearns in connection with Enron s bankruptcy proceedings until Bear Stearns has paid that amount to Enron and (c) awarding Enron its reasonable attorneys fees and costs incurred in connection with the proceeding.

(iv) Enron Corp., et al. v. Bear, Stearns & Co. Inc., et al.: Bear Stearns has been named as a defendant in two adversary proceedings commenced by Enron in the United States Bankruptcy Court for the Southern District of New York. The complaints in these actions seek equitable subordination and disallowance under the Bankruptcy Code of certain debt claims against Enron in the amount of $19 million that were purchased by Bear Stearns from third parties subsequent to Enron s filing for bankruptcy.

Bear Stearns denies all allegations of wrongdoing asserted against it in these litigations and believes that it has substantial defenses to these claims.

IPO Allocation Securities and Antitrust Litigations

The Company, along with many other financial services firms, has been named as a defendant in many putative class actions filed during 2001 and 2002 in the United States District Court for the Southern District of New York involving the allocation of securities in certain initial public offerings (IPOs). The complaints in these purported class actions generally allege, among other things, that between 1998 and 2000: (i) the underwriters of certain hot IPOs of technology and internet-related companies obtained excessive compensation by allocating shares in these IPOs to preferred customers who, in return, purportedly agreed to pay additional compensation to the underwriters, and the underwriters failed to disclose this additional compensation and/or (ii) the underwriters customers, in return for a favorable allocation of these securities, agreed to purchase additional shares in the aftermarket at pre-arranged prices or to pay additional compensation in connection with other transactions.

Beginning on April 19, 2002, the plaintiffs in these litigations filed amended complaints by virtue of which the public offerings of each of the 309 issuers are now the subjects of separate complaints. Bear Stearns is a defendant in 95 of these amended complaints. As amended, the complaints allege, among other things, that the underwriters, including Bear Stearns, violated Section 11 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, based on the wrongdoing alleged in the original complaints and by causing their securities analysts to issue unwarranted positive reports regarding the issuers. Compensatory damages in unspecified amounts are sought.

By order dated October 13, 2004, the court granted in part and denied in part class certification for each of the six cases selected to be the focus cases for these proceedings.

By opinion and order dated February 15, 2005, the Court preliminarily approved the proposed settlement among plaintiffs and a substantial number of the non-bankrupt issuer defendants and their officers and directors. The settlement generally provided that (1) the insurers of these issuers will guarantee an ultimate recover by plaintiffs, in this and related litigations, of $1 billion; (2) these issuers will assign to plaintiffs so-called excess compensation claims against the underwriter defendants, including Bear Stearns, that these issuers allegedly possess; and (3) plaintiffs will, upon final approval of the settlement, dismiss all claims against these issuers and the individual director and officer defendants. That preliminary approval, however, was conditioned upon certain changes being made to the terms of the settlement.

In January 2002, the Company was named as a defendant, along with nine other financial services firms, in an antitrust complaint filed in the same court on behalf of a putative class of purchasers who, either in IPOs or the aftermarket, purchased technology-related securities during the period March 1997 to December 2000. Plaintiffs allege that the defendants conspired to require that customers, in return for an allocation in the IPOs, (i) pay charges in addition to the IPO price, such as non-competitively determined commissions on the purchase or sale of other securities and/or (ii) agree to purchase the IPO securities in the aftermarket at prices above the IPO price. Plaintiffs claim that these alleged practices violated Section 1 of the Sherman Act and state antitrust laws and seek compensatory and treble damages. On November 6, 2003, the Court granted the motion of the defendants (including the Company) to dismiss all claims asserted against them by these antitrust plaintiffs. The plaintiffs appealed that decision to the Second Circuit Court of Appeals. On September 28, 2005, the Second Circuit Court of Appeals vacated the dismissal and remanded this matter to the lower court for further proceedings.

The Company denies all allegations of wrongdoing asserted against it in these litigations and believes that it has substantial defenses to these claims.

IPO Underwriting Fee Antitrust Litigation: Bear Stearns, along with numerous other financial services firms, is a defendant in several consolidated class actions currently pending in the United States District Court for the Southern District of New York. The first consolidated action, filed on March 15, 2001, purports to be brought on behalf of a putative class of purchasers of stock in initial public offerings (the Purchaser Action). The second consolidated action, filed on July 6, 2001, purports to be brought on behalf of a putative class of issuers of stock in initial public offerings (the Issuer Action). Each suit alleges that Bear Stearns violated federal antitrust laws by fixing underwriting fees at 7% for initial public offerings with an aggregate issuance value of $20-$80 million for the time period 1994 to the present. The plaintiff in each action seeks injunctive relief and treble damages.

On February 24, 2004, the district court granted defendants motion to dismiss the complaint in the Purchaser Action in part, dismissing plaintiffs claim for treble damages under Section 4 of the Clayton Act. However, the court denied defendants motion to dismiss the plaintiffs claim for injunctive relief.

On September 16, 2004, plaintiffs in the Purchaser Action and Issuer Action moved for class certification. On October 25, 2005, plaintiffs in both actions moved for partial summary judgment against defendants on liability.

Bear Stearns has denied all allegations of wrongdoing asserted against it in these litigations and believes that it has substantial defenses to these claims.

Mutual Fund Matters: The following matters arise out of mutual fund trading:

(i) Regulatory: Bear Stearns and BSSC have submitted an Offer of Settlement to the SEC and the NYSE to resolve investigations by these agencies relating to mutual fund trading. The settlement offer, which was negotiated with the staffs of the SEC and NYSE and will be recommended by them, is subject to approval by the respective regulators. Terms include a payment of $250 million and retention of independent consultants to review aspects of its mutual fund trading and global clearing operations.

(ii) Litigation: On November 7, 2003, BSSC, the Company and Bear Stearns, together with 18 other entities and individuals, were named as defendants in a purported class action lawsuit, in the United States District Court for the Southern District of New York by a mutual fund investor on behalf of persons who purchased and/or sold ownership units of mutual fund in the Janus or Putnam families of mutual funds between November 1, 1998 and July 3, 2003. On January 26, 2004, plaintiff filed a first amended complaint, again on behalf of persons who traded in the Janus or Putnam families of mutual funds, against the same Bear Stearns entities and 16 other entities and individuals, including mutual funds and other financial institutions. On October 22, 2003, another purported class action was filed on behalf of the general public of the State of California against multiple defendants, including the Company, with respect to various mutual funds. Both of these actions allege that the defendants violated federal and/or state laws by allowing certain investors to market time and/or late trade mutual fund shares and seek various forms of relief including damages of an indeterminate amount. On March 19, 2004, these actions were transferred to the District of Maryland for coordinated and/or consolidated pre-trial proceedings as part of MDL 1586- In re Mutual Funds Investment Litigation.

On or subsequent to September 29, 2004, fifteen new and/or amended class action or derivative complaints were filed in MDL-1586 naming as defendants the Company, Bear Stearns and/or BSSC (the Bear Stearns defendants), various mutual fund companies, certain broker-dealers, and others. Plaintiffs who have brought actions, either directly or derivatively, against one or more of the Bear Stearns defendants are shareholders in the following families of mutual funds: AIM, Invesco, PIMCO/Allianz Dresdner, Excelsior, Alliance, Franklin Templeton, One Group, Strong, Columbia, Pilgrim Baxter, Alger, Janus, RS and MFS. Among other things, the actions allege that the defendants violated federal and/or state laws by allowing certain investors to market time and/or late trade mutual fund shares and seek various forms of relief including damages of an indeterminate amount.

The Bear Stearns defendants, along with other broker-dealer defendants, had filed an omnibus motion to dismiss the consolidated class action and derivative claims against them. On November 3, 2005, the derivative claims against the Bear Stearns defendants were dismissed. As of December 31, 2005, the Bear Stearns defendants motion to dismiss has been granted in part and denied in part as to direct investor claims in the following families of mutual funds: Janus, AIM/Invesco, RS, One Group, MFS, Columbia, PIMCO/Allianz Dresdner, Alger, Excelsior and Strong.

The Bear Stearns defendants believe that they have substantial defenses to the remaining claims.

Bear Wagner Specialists LLC (Bear Wagner): Bear Wagner, a subsidiary of the Company, is among numerous defendants named in purported class actions brought on behalf of investors beginning in October 2003 in the United States District Court for the Southern District of New York alleging violations of the federal securities laws in connection with NYSE floor specialist activities. The actions seek unspecified compensatory damages, restitution, and disgorgement on behalf of purchasers and sellers of unspecified securities between October 17, 1998 and October 15, 2003. Bear Wagner and the Company are also among the defendants in a purported class action filed in December 2003 in California Superior Court, Los Angeles County alleging violation of California law in connection with the same conduct. This case was transferred to the United States District Court for the Southern District of New York. The district court consolidated these purported class actions under the caption In re NYSE Specialists Securities Litigation, No. 03 Civ. 8264 (RWS). On September 15, 2004, a consolidated amended complaint was filed in this action.

Bear Wagner and the Company deny all allegations of wrongdoing in the class action specialist litigations and believe they have substantial defenses to the claims.

In re Prime Hospitality, Inc. Shareholders Litigation: On July 15, 2005, plaintiff shareholders of Prime Hospitality Corporation (Prime) filed a consolidated amended class action complaint in the Delaware Chancery Court against the directors of Prime, the Blackstone Group (Blackstone) and certain affiliates of Blackstone, and Bear Stearns. As amended, the complaint alleges that Bear Stearns acted as financial advisor to Prime in connection with the sale of Prime to Blackstone, and that Bear Stearns aided and abetted a breach of fiduciary duty by the directors of Prime in connection with that transaction. The amended complaint seeks from defendants compensatory damages in an unspecified amount, as well as various forms of equitable relief, including, but not limited to, rescissory damages, the imposition of a constructive trust and an accounting. On October 3, 2005, Bear Stearns filed its answer to the consolidated amended class action complaint denying all allegations of wrongdoing and asserted affirmative defenses.

Bear Stearns believes that it has substantial defenses to the claims in this matter.

Municipal Bond Offering Matters

Bear Stearns has been notified by the Chicago office of the SEC of a formal investigation into its municipal bond offering practices, which has been focused on the municipal underwriting business conducted through the Chicago office of Bear Stearns. Bear Stearns has also received subpoenas and requests for information relating to its municipal underwriting business and/or public fund asset management business conducted through the Chicago office of Bear Stearns from the United States Attorney s Office for the Northern District of Illinois; the State of Illinois, Office of Executive Inspector General; the Illinois Securities Department; and the Office of the Attorney General of Illinois.

Bear Stearns is cooperating with each of these investigations or inquiries.

Other Investigations/Inquiries

Bear Stearns has been notified by the Staff of the SEC, Southeast Regional Office, that the Staff intends to recommend that the Commission bring a civil enforcement action against Bear Stearns in connection with Bear Stearns involvement in the pricing, valuation and analysis related to approximately $62.9 million of collateralized debt obligations that were purchased by a client of Bear Stearns. Such an action could result in, among other things, disgorgement, civil monetary penalties and/or other remedial sanctions.

The Company is also continuing to respond to subpoenas and other requests for information from regulatory and law enforcement agencies relating to certain collateralized debt obligations.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Executive Officers of the Company

The following table sets forth certain information as of January 31, 2006 concerning executive officers of the Company.

Name	Age as of January 31, 2006	Principal Occupation
James E. Cayne	71	Chairman of the Board and Chief Executive Officer of the Company and Bear Stearns and member of the Executive Committee of the Company (the Executive Committee)
Jeffrey M. Farber	41	Controller of the Company and Bear Stearns
Alan C. Greenberg	78	Chairman of the Executive Committee
Michael Minikes	62	Treasurer of the Company and Bear Stearns
Samuel L. Molinaro Jr.	48	Executive Vice President and Chief Financial Officer of the Company and Bear Stearns and member of the Executive Committee
Alan D. Schwartz	55	President and Co-Chief Operating Officer of the Company and Bear Stearns and member of the Executive Committee
Michael S. Solender	41	General Counsel of the Company and Bear Stearns
Warren J. Spector	48	President and Co-Chief Operating Officer of the Company and Bear Stearns and member of the Executive Committee

Business experience for the past five years is provided in accordance with SEC rules.

Mr. Cayne became Chairman of the Board on June 25, 2001. Mr. Cayne has been Chief Executive Officer of the Company and Bear Stearns for more than five years and prior to June 25, 2001, was President of the Company and Bear Stearns.

Mr. Farber has been Controller of the Company and Bear Stearns since January 7, 2004. Mr. Farber was Assistant Controller of the Company from May 2000 to January 7, 2004 and since May 1, 2000 a Senior Managing Director of Bear Stearns. Prior to May 2000, Mr. Farber was a partner with Deloitte & Touche LLP.

Mr. Greenberg has been Chairman of the Executive Committee for more than five years and prior to June 25, 2001, was Chairman of the Board of the Company.

Mr. Minikes has been Treasurer of the Company and Bear Stearns for more than five years.

Mr. Molinaro became Executive Vice President of the Company and Bear Stearns on December 1, 2001, and has been Chief Financial Officer of the Company and Bear Stearns since October 1996.

Mr. Schwartz became President and Co-Chief Operating Officer of the Company and Bear Stearns and a member of the Executive Committee on June 25, 2001, and was an Executive Vice President of Bear Stearns for more than five years.

Mr. Solender became General Counsel of the Company and Bear Stearns on January 29, 2004. Since February 11, 2002, Mr. Solender has been a Senior Managing Director in the Legal Department of Bear Stearns. Mr. Solender was a partner at the law firm of Arnold & Porter LLP from January 1997 to January 2000 and from November 2001 to February 2002, and was General Counsel of the U.S. Consumer Product Safety Commission from January 2000 to November 2001.

Mr. Spector became President and Co-Chief Operating Officer of the Company and Bear Stearns and a member of the Executive Committee on June 25, 2001, and was an Executive Vice President of Bear Stearns for more than five years.

Officers serve at the discretion of the Board of Directors.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The information relating to the market for registrant s common equity required to be furnished pursuant to this item is set forth under the caption Price Range of Common Stock and Dividends in the Annual Report, which is incorporated herein by reference to Exhibit No. 13 of this report.

The following table provides information as of November 30, 2005 with respect to the shares of common stock repurchased by the Company during the fourth quarter of fiscal 2005:

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
9/1/05 - 9/30/05	51,965	$103.34	51,965	$753,231,207
10/1/05 - 10/31/05				$753,231,207
11/1/05 - 11/30/05	3,359,964	$106.67	3,359,964	$394,815,266
Total	3,411,929			