



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

SCOTT G. ALVAREZ  
GENERAL COUNSEL

July 18, 2007

Gary Rice, Esq.  
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425 Lexington Avenue  
New York, New York 10017-3954

Dear Mr. Rice:

This responds to your letter of July 13, 2007, and related correspondence, requesting confirmation that a proposed investment in Doral Financial Corporation ("Doral Financial"), San Juan, Puerto Rico, a registered bank holding company, would not cause The Bear Stearns Companies, Inc. ("Bear Stearns"), New York, New York, to lose certain grandfather rights that it has under section 4(f) of the Bank Holding Company Act ("BHC Act").<sup>1</sup> You also have requested confirmation that Bear Stearns would not be deemed to control Doral Financial or any Doral Investment Entity (as defined below) for purposes of the BHC Act as a result of its proposed investment in, and business relationships and interlocks with, Doral Financial.

The Proposal

Bear Stearns has arranged a proposed transaction to provide Doral Financial with a significant amount of new equity financing. Under the proposal, numerous investors, including Bear Stearns, would invest a total of approximately \$627 million in Doral Holdings, L.P. ("Holdings LP"), a limited partnership that is organized under the laws of the Cayman Islands. The sole general partner of Holdings LP would be Doral GP Ltd. ("Holdings GP"), a company organized in the Cayman Islands.<sup>2</sup> Holdings LP then would contribute approximately \$627 million to Doral Holdings Delaware, LLC ("Holdings LLC" and, collectively with Holdings LP and Holdings GP, the "Doral Investment Entities"), a limited liability company organized under the laws of Delaware, in return for 99.5 percent of the limited liability interests of Holdings LLC.<sup>3</sup> Holdings LLC then would purchase approximately \$610 million of newly issued voting common stock of

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<sup>1</sup> See 12 U.S.C. § 1843(f).

<sup>2</sup> Holdings GP will not have an equity investment in Holdings LP.

<sup>3</sup> Holdings LP also will be the managing member of Holdings LLC. Bear Stearns, through BSMB (as defined below), would acquire the remaining 0.5 percent of the limited liability interests of Holdings LLC, in the form of nonvoting securities.

Doral Financial, which would represent approximately 90 percent of the voting shares of Doral Financial. Each Doral Investment Entity would become a bank holding company.

Under the proposal, several investment partnerships controlled by the merchant banking group of Bear Stearns (collectively, "BSMB") would own in the aggregate about 4.3 percent of the total equity of Holdings LP in the form of nonvoting limited partner interests. Bear Stearns Merchant Capital III (Cayman), L.P. ("BSMC"), the general partner of BSMB, also would own about 0.2 percent of the total equity of Holdings LP in the form of nonvoting limited partner interests.

Limited partner investors in BSMB (the "BSMB Investors"), all unaffiliated with Bear Stearns, would own approximately 16 percent of the total equity and voting interests of Holdings LP in the form of voting limited partner interests. Each BSMB Investor has made an independent decision to invest in Holdings LP, would not make its investment in Holdings LP through BSMB (or any other Bear Stearns-affiliated entity), and would not have agreements or understandings with any Bear Stearns-controlled entity regarding the voting or transfer of its interest in Holdings LP. Through its limited partner interest in Holdings LP, BSMC would receive a carried interest that would be charged to the BSMB Investors and certain other limited partner investors in Holdings LP.<sup>4</sup>

Bear Stearns Merchant Banking III AIV (Cayman) Ltd., a company that is a general partner of BSMC and is controlled by Bear Stearns, would invest in 4.9 percent of the voting interests and total equity of Holdings GP. The remainder of the equity of Holdings GP would be owned by [ ] other limited partner investors in Holdings LP that are not affiliated with each other or with Bear Stearns and are not BSMB Investors. Each of these other investors would own at least 7 percent and not more than 9.9 percent of the voting interests and total equity of Holdings GP. Each investor in Holdings GP would be party to a shareholders agreement<sup>5</sup> under which Bear Stearns and four of the

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<sup>4</sup> Bear Stearns had originally proposed that any carried interest paid by a BSMB Investor to Bear Stearns as a result of the performance of BSMB would be subject to a "clawback" in the event that the investment by the BSMB Investor in Holdings LP did not meet a contractually promised rate of return. In light of concerns raised by Board staff about whether an agreement to link economically the Doral Financial investment to unrelated investments made through BSMB indicates that Bear Stearns and the BSMB Investors were acting as an association or that Bear Stearns was acting indirectly through the BSMB Investors, Bear Stearns agreed to revise the proposal to remove the cross-fund carried interest clawback.

<sup>5</sup> Bear Stearns has represented that the shareholders agreement conforms to the Board's interpretation on voting trusts and buy-sell agreements. Letter dated May 4, 1972, from Tynan Smith, Secretary of the Board, to the Presidents of the Federal Reserve Banks (Federal Reserve Regulatory Service 4-185.5). The agreement relates only to the equity of a single bank holding company; terminates within 25 years; serves no function other than to impose certain transfer and voting restrictions on equity holders in Holdings GP; and involves parties who are not, and will not become, parties to any similar agreement with respect to any other banking or nonbank organization.

other investors (the "Designating Members") would have the ability to designate one member of the five-member board of directors of Holdings GP.<sup>6</sup> Actions by the board of directors of Holdings GP generally will be by majority vote, and in no circumstance will a single director be able to block an action by the board of directors of Holdings GP. The Bear Stearns representative on the board of Holdings GP would be designated by Bear Stearns and not by the BSMB Investors. No Bear Stearns entity will designate a representative of any of the other [ ] investors. Upon consummation of the proposal, the board of directors of Doral Financial would have eleven members, including the five directors designated by the Designating Members of Holdings GP.

Bear Stearns also proposes to have several material business relationships with Doral Financial going forward. Doral Financial expects to enter into an advisory services agreement with Bear Stearns Merchant Manager III (Cayman), L.P. ("BSMM"), pursuant to which BSMM would provide advice to Doral Financial regarding acquisitions and dispositions, financings, procurement, information technology, accounting, and tax matters. BSMM would make recommendations to Doral Financial but would not have authority to take any actions on behalf of Doral Financial, and Doral Financial would be under no obligation to act in accordance with any recommendation provided by Bear Stearns. BSMM would receive an advisory fee for its services under the agreement, and the arrangement would be on nonexclusive terms and could be terminated by Doral Financial without material penalty on 60 days notice. In addition, Bear Stearns may act as a financial adviser with respect to a proposed purchase by Doral Financial of a third party's retail banking operations in Puerto Rico; may maintain a [ ] million line of credit previously extended to Doral Financial; and may purchase assets from Doral Financial and sell assets to Doral Financial in amounts up to 10 percent of the assets originated or purchased by Doral Financial in any two-year period so long as those purchases are consistent with the 5 percent of assets limitation set forth in section 4(f)(2)(A)(ii) of the BHC Act.<sup>7</sup>

Bear Stearns has made certain passivity commitments with respect to the Doral Investment Entities, Doral Financial, and the subsidiary insured depository institutions of Doral Financial (collectively, the "Doral Entities") that are substantially similar to the passivity commitments that the Board has relied on in previous cases in finding that an

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<sup>6</sup> In the event that one of the five Designating Members reduces its interest in Holdings LP by 50 percent or more, the remaining Designating Members will select a replacement designating investor that is not affiliated with any of the remaining Designating Members.

<sup>7</sup> As discussed in more detail below, section 4(f)(2)(A)(ii) of the BHC Act prohibits Bear Stearns from acquiring more than 5 percent of the assets of an additional insured depository institution. To comply with this provision, assets held by Bear Stearns at any one time that were previously purchased from a subsidiary insured depository institution of Doral Financial may not represent more than 5 percent of the assets of such depository institution.

investment was noncontrolling.<sup>8</sup> Under these commitments, among other things, Bear Stearns commits not to take any action that may cause the Doral Entities to become a subsidiary of Bear Stearns; not to acquire or retain shares of the Doral Entities that would cause Bear Stearns (including its affiliates, members of its executive committee, its directors, and any of its employees involved in the proposed transaction) to own 5 percent or more of the outstanding shares of any Doral Entity;<sup>9</sup> not to exercise or attempt to exercise a controlling influence over the management or policies of the Doral Entities; not to have or seek to have more than one representative serve as a director of the Doral Entities; and not to have or seek to have any representative serve as an officer, agent, or employee of the Doral Entities.

Bear Stearns also has made certain representations regarding its independence from the other investors in the Doral Investment Entities. Among other things, Bear Stearns has represented that it: (i) is not affiliated with any other investor in Holdings LP; (ii) reached its decision to invest in the Doral Investment Entities independently from the other investors; (iii) has entered into no agreements with the other investors for the purpose of controlling the Doral Investment Entities (other than as set forth in the organizational documents of the Doral Investment Entities and in the Holdings GP shareholders agreement that were provided to Board staff); (iv) has entered into no agreements with the other investors regarding voting its interest in the Doral Investment Entities in concert with the other investors, or otherwise to act in concert with the other investors with respect to the Doral Investment Entities (other than as set forth in the organizational documents of the Doral Investment Entities and in the Holdings GP shareholders agreement that were provided to Board staff); and (v) will not consult with the other investors regarding the voting of its interest in the Doral Investment Entities (except as provided in the Holdings GP shareholders agreement regarding the election of directors). In addition, Bear Stearns cannot restrict any other investor's ability to transfer its interests in the Doral Investment Entities.

#### Legal Framework and the Grandfather Status of Bear Stearns

Bear Stearns owns Custodial Trust Company ("CTC"), a New Jersey-chartered state nonmember bank that engages primarily in custody and securities portfolio servicing. Although CTC is a bank for purposes of the BHC Act, Bear Stearns is not treated as a bank holding company under the BHC Act because it qualifies for the grandfather rights provided by section 4(f) of the BHC Act. Under section 4(f) of the

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<sup>8</sup> These passivity commitments are set forth in the attachment to this letter.

<sup>9</sup> Doral Entity securities held by these officers, directors, and employees over which a third-party manager has investment and voting discretion would not be attributed to Bear Stearns for purposes of determining compliance with this commitment so long as the securities were not acquired by the third-party manager in order to evade this commitment. Bear Stearns also has committed that it will not influence or attempt to influence how Bear Stearns officers, directors, or employees vote any securities issued by a Doral Entity.

BHC Act, Bear Stearns may continue to avoid treatment as a bank holding company only if, among other things, Bear Stearns abides by the conditions set forth in section 4(f)(2) of the BHC Act. Under these conditions, Bear Stearns generally may not, directly or indirectly, acquire more than 5 percent of the shares or assets – or control – of an additional insured depository institution.<sup>10</sup>

#### Discussion and Analysis

##### A. The 5% Test – Section 4(f)(2)(A)(ii) of the BHC Act

As noted above, to preserve its grandfather rights, Bear Stearns may not directly or indirectly acquire control of more than 5 percent of the shares or assets of an additional insured depository institution. Accordingly, Bear Stearns may not directly or indirectly acquire control of more than 5 percent of the shares or assets of any of the Doral Entities.

On consummation of the proposal, neither Bear Stearns nor any subsidiary of Bear Stearns directly would acquire any voting or equity interest in Doral Financial or in any insured depository institution subsidiary of Doral Financial. Bear Stearns and its subsidiaries would, however, acquire 4.9 percent of the voting equity of Holdings GP, 4.4 percent of the nonvoting equity of Holdings LP, and 0.5 percent of the nonvoting equity of Holdings LLC, each bank holding companies. Accordingly, Bear Stearns would not, directly or indirectly, own more than 5 percent of the shares of any additional insured depository institution or bank holding company as a result of the proposal. Moreover, Bear Stearns and its subsidiaries would own less than 5 percent of the total equity of the Doral Investment Entities viewed on a consolidated basis.

Although the BSMB Investors would own approximately 16 percent of the voting interest and total equity of Holdings LP, and BSMC would receive a carried interest from the BSMB Investors based on the performance of the Doral Financial investment, staff has concluded that the investments in Holdings LP by the BSMB Investors should not be attributed to Bear Stearns for purposes of section 4(f)(2)(A)(ii) of the BHC Act. As noted above, although the BSMB Investors are existing advisory clients of Bear Stearns, they are not affiliates of Bear Stearns and they have made an independent decision to invest in Holdings LP. In addition, they would not make their investment in Holdings LP through any Bear Stearns-affiliated entity and would not have agreements or understandings with any Bear Stearns-controlled entity regarding the voting or transfer of their limited partner interest in Holdings LP. Moreover, the carried interest does not represent an interest in any shares of a Doral Entity.

Based on all the facts of record, staff would not recommend at this time that the Board determine that consummation of the proposal would cause Bear Stearns to lose its grandfather rights as a result of a violation of section 4(f)(2)(A)(ii) of the BHC Act.

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<sup>10</sup> 12 U.S.C. § 1843(f)(2)(A)(i) and (ii).

B. The Control Test – Section 4(f)(2)(A)(i) of the BHC Act

As noted above, to preserve its grandfather rights, Bear Stearns may not directly or indirectly acquire control of an additional insured depository institution. Accordingly, Bear Stearns may not directly or indirectly acquire control of any Doral Entity. For purposes of the BHC Act, a company has control over another company if the company (i) directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other company; (ii) controls in any manner the election of a majority of the directors of the other company; or (iii) directly or indirectly exercises a controlling influence over the management or policies of the other company.<sup>11</sup> The Board's Regulation Y also sets forth a set of rebuttable presumptions of control.<sup>12</sup>

Under the proposal, Bear Stearns only would be deemed to control a Doral Entity for purposes of the BHC Act if the Board were to find that Bear Stearns exercised a controlling influence over the management or policies of the Doral Entity. Bear Stearns would not own, control, or hold with power to vote 25 percent or more of any class of voting securities of, or control the election of a majority of the directors of, any Doral Entity.<sup>13</sup> In addition, Bear Stearns would not trigger any of the rebuttable presumptions of control in Regulation Y with respect to any Doral Entity.

The size and nature of the equity investment by Bear Stearns in the Doral Investment Entities – when combined with the substantial business relationships between Bear Stearns and Doral Financial, the Bear Stearns representation on the boards of directors of Holdings GP and Doral Financial, and the important role of Bear Stearns in arranging the proposal – raise the issue of whether Bear Stearns would have a controlling influence over the management or policies of Doral Financial.

A number of mitigating features, described above, constrain the ability of Bear Stearns to influence the management and policies of the Doral Entities, including:

- The investment by Bear Stearns would represent less than 5 percent of the voting interest and total equity of each Doral Entity.
- The BSMB Investors (i) are not affiliates of Bear Stearns; (ii) have made an independent decision to invest in Holdings LP; (iii) would not make their investment in Holdings LP through any Bear Stearns-affiliated entity;

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<sup>11</sup> 12 U.S.C. § 1841(a)(2); 12 CFR 225.2(e).

<sup>12</sup> See 12 CFR 225.31(d).

<sup>13</sup> There is no agreement among the investors in Holdings GP regarding the selection of directors of Holdings GP, other than as set forth in the Holdings GP shareholders agreement. [

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- and (iv) would not have agreements or understandings with Bear Stearns regarding the voting or transfer of their interests in Holdings LP.
- Bear Stearns would not be the largest shareholder of any of the Doral Entities. Eleven sophisticated institutional investors unaffiliated with Bear Stearns (and other than the BSMB Investors) each would own between 7 and 9.9 percent of the voting interest and total equity of Holdings GP, and four of these other investors each would own between 9.1 and 9.9 percent of the voting interest and total equity of Holdings LP.
  - Bear Stearns has provided passivity commitments that the Board has relied on previously to make non-control determinations in the context of similar investments. Although the commitments would permit Bear Stearns and Doral Financial to engage in the business relationships described in this letter, these relationships are limited in amount, non-exclusive, and on arm's length terms.

In view of all the facts of record in this case – including in particular the attached passivity commitments made by Bear Stearns, the small relative size of the voting and equity investment by Bear Stearns in the Doral Entities, the presence of several other larger investors, and the independence of the BSMB Investors – staff would not at this time recommend that the Board find that the proposal would allow Bear Stearns to exercise a controlling influence over the management or policies of Doral Financial or any of the Doral Investment Entities for purposes of the BHC Act or result in a violation of section 4(f)(2)(A)(i) of the BHC Act.

This opinion is limited to the transactions described above and is based on the facts, representations, and commitments included in your letter and related correspondence. The commitments are deemed to be conditions imposed in writing by the Federal Reserve System in connection with its findings and decision on the applications and notices filed by the Doral Investment Entities to obtain prior approval of the Federal Reserve System pursuant to sections 3 and 4 of the BHC Act to acquire Doral Financial and its subsidiaries. Any material change in the facts presented may result in a different conclusion and should be reported to Board staff.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott G. O'Connell". The signature is written in a cursive style and is positioned above a large, empty oval shape, which likely represents a placeholder for a stamp or a signature line.

**APPENDIX**  
***Commitments by Bear Stearns***

Bear Stearns commits that it will not directly or indirectly, take any of the actions referred to in the commitments below.

1. Bear Stearns will not take any action that may cause Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries to become a subsidiary of Bear Stearns.
2. Bear Stearns will not acquire or retain shares that would cause it, its affiliates, its directors, Executive Committee members, and officers and employees of BSMB who are involved in the proposed transaction, to own 5 percent or more of the outstanding shares of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries, provided that shares owned by directors of Bear Stearns, Bear Stearns Executive Committee members, and officers and employees of BSMB who are involved in the proposed transaction in accounts or funds which are managed by third parties or for which third parties have investment discretion shall not be considered as owned by such persons as long as such shares are not placed in such accounts or funds for the purpose of evading this commitment. In addition, Bear Stearns will place the shares of Doral Financial on its restricted list and will not influence or attempt to influence how Bear Stearns officers, directors or employees vote any shares they may hold of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries.
3. Bear Stearns will not exercise or attempt to exercise a controlling influence over the management or policies of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries.
4. Bear Stearns will not have or seek to have any representative serve as an officer, agent or employee of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or of their subsidiaries.
5. Bear Stearns will not enter into any other banking or non-banking transaction with Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries, except that (i) BSMM may maintain the Advisory Services Agreement; (ii) Bear Stearns' investment banking group may act as financial adviser with respect to the proposed purchase by Doral Financial of [ ] retail banking operations in Puerto Rico, (iii) Bear Stearns may maintain the existing [ ] million line of credit it has provided to Doral Financial, (iv) Bear Stearns may continue to purchase from Doral Financial and its subsidiaries and sell to Doral Financial and its subsidiaries mortgage loans in transactions in which Doral Financial or its subsidiary receives no less than three competitive bids from nationally recognized financial institutions, provided that, on a trailing twenty four month basis, such transactions do not exceed 10% of the dollar value of all loans originated or purchased from third parties by Doral Financial and its subsidiaries; and (v) Bear Stearns may enter into transactions with Doral Financial and its subsidiaries not involving mortgage loans (such as purchases or sales of securities or derivative

transactions), provided that such other transactions do not constitute, on a trailing twenty four month basis, more than 10% of the dollar value of such transactions entered into by Doral Financial and its subsidiaries. All transactions between Bear Stearns on the one hand and Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries on the other, will be on an arm's length basis and shall not restrict Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries from entering into transactions of the same type with other parties.

6. Bear Stearns will not seek or accept representation on the board of directors of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries, except that it may be represented on the board of directors of Holdings GP by one director, who may also serve on the board of directors of Doral Financial.

7. Bear Stearns will not propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries.

8. Bear Stearns will not solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries, except to the extent Bear Stearns may be deemed to solicit or participate in soliciting proxies as a result of being represented by one director on the board of directors of Doral Financial, as described in paragraph 6 above.

9. Bear Stearns will not attempt to influence the dividend policies; loan, credit, or investment decisions or policies; pricing of services; personnel decisions; operations activities, including the location of any offices or branches or their hours of operation, etc.; or any similar activities or decisions of Holdings GP, Holdings LP, Holdings LLC, Doral Financial or any of their subsidiaries; provided that the director designated by Bear Stearns to serve on the Holdings GP board of directors and the Doral Financial board of directors will be permitted to fully participate as a director on such boards of directors, and BSMM will be permitted to provide advisory services in accordance with the terms of the Advisory Services Agreement.

10. Bear Stearns will not dispose or threaten to dispose of shares of Holdings GP, Holdings LP, Holdings LLC or Doral Financial directly or indirectly held by it in any manner as a condition of specific action or nonaction by Holdings GP, Holdings LP, Holdings LLC or Doral Financial.