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Confidential ***Presentation to:***

Board of Directors

State of Lehman Brothers' Subprime Mortgage Business

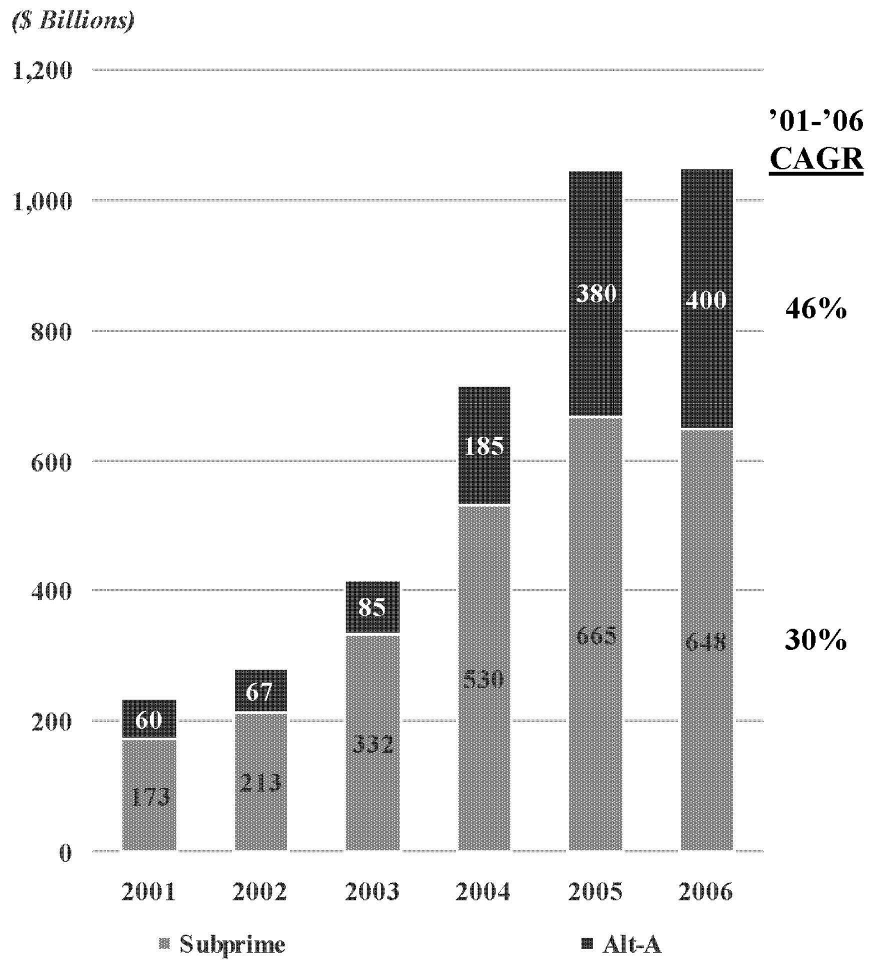
March 20, 2007

LEHMAN BROTHERS

Mortgage Origination Market Overview

Rapid growth in sub-prime mortgage originations fuelled by credit product innovation and increased appetite for credit risk from capital markets

Subprime and Alt-A Mortgage Origination Volume [1]



(1) Sources: *Inside Mortgage Finance, Inside Alternative Mortgages.*

Market Commentary

- Subprime segment grew at a 30% CAGR from 2001-2006
  - Overall market (including prime) grew at a 6% CAGR from 2001-2006
- Subprime segment comprised 22% of overall mortgage market in 2006 vs. 8% in 2001
- Characteristics of subprime market segment
  - Loans to individuals with poor credit scores
    - Average FICO: 620-630
  - Lack of or limited documentation of income and assets
  - High proportion of market focused on adjustable rate refinancing product
- Drivers of subprime market growth
  - Credit and product innovation
    - Advances in evaluating household credit risk
    - Products developed to meet customers' credit profile
  - Increasing risk appetite in capital markets
    - Growth of securitization market
    - MBS / CDOs have provided higher yielding investments in low interest rate environment

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Evolution of Subprime Market Dynamics

Attractive economics led to growth of businesses. Lending standards loosened as firms tried to maintain volumes, coinciding with housing market deterioration

	2003-05	2005+	
	Benign Environment	**Interest Rates Increased**	
Economic / Housing Environment	◆ Low interest rates ◆ Rising housing prices ◆ Historically low delinquencies	◆ Fed Funds Rate increased 17 times ◆ Housing prices stabilized / began declining in "hottest" markets	**Thinly Capitalized, Monoline Originators Face Major Issues** ◆ More marginal customers received loans – Growing delinquency rates ◆ Securitization desks are sending back unqualified loans ◆ Warehouse lenders are tightening funding
	Attractive Economics	**Competition Intensified**	
Subprime Competitive Dynamics	◆ Strong pre-tax profit margins (40-50%) ◆ Growth of existing players ◆ Influx of new entrants ◆ Strong growth of origination volumes – Large volumes sold into capital markets	◆ Lenders sought to maintain origination volumes – loosened lending criteria – Lower credit standards • Low documentation, high LTV – Riskier loan structures • E.g., Teaser rates, Interest Only, 40/50 year terms – Layering of lower credit standards and riskier loan structures ◆ Capital markets continued to buy loans – Rating agencies maintained ratings	

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Impact on Subprime Originators

8 of top 10 independents being sold or going out of business

Top 20 Subprime Wholesale and Retail Originators of 2006 (1)

Rank	Firm	2006 Production ($BN) Total	Wholesale	Retail	Market Cap ($MM)	Charge-offs ($MM)	Status
1	New Century	51.6	47.5	4.1	67		Funding frozen; stock delisted; criminal investigation
2	HSBC	50.8	38.6	12.2	NA		Impairment charge up 70%; fired senior U.S. managers
3	Countrywide	40.6	25.4	15.2	NA		Foreclosures at 5-yr high; cutting jobs
4	CitiMortgage	38.0	17.9	20.2	NA		Buying distressed businesses
5	WMC Mortgage (GE)	33.2	33.2	0.0	NA		Cutting 20% of workforce
6	Fremont General	32.3	32.3	0.0	576		Stock down 54% YTD; selling subprime operation
7	Ameriquest	29.5	22.6	6.9	NA		Cutting workforce; selling business
8	Option One (H&R Block)	28.8	26.8	2.0	NA		Near agreement to sell business
9	Wells Fargo	27.9	8.9	19.0	NA		Cutting workforce
10	First Franklin	27.7	25.4	2.3	29		Bought by Merrill Lynch in 2006
11	Washington Mutual	26.6	26.6	0.0	NA		Cutting workforce
12	ResCap (GMAC)	21.2	20.9	0.3	NA		4Q06 operating loss of $651 million
13	Aegis Mortgage (Cerberus)	17.0	10.2	6.8	NA		
14	Accredited Home Lenders	15.8	13.4	2.4	234		Stock down 66% YTD; considering strategic options
15	BNC (Lehman Brothers)	13.7	13.7	0.0	NA		
16	Chase Home Finance	11.6	6.9	4.6	NA		
17	American General Finance	11.5	10.5	1.0	NA		
18	Equifirst	10.8	10.8	0.0	NA		Bought by Barclays in 2007
19	Nationstar	4.6	1.0	3.6	NA		Bought by Fortress in 2006
20	Delta Financial	4.0	2.1	2.0	209		Stock down 12% YTD

Sold / selling or bankrupt
Current remaining independents

Given reduction of independent players, it will become more difficult for I-banks without vertically integrated platforms to source subprime product to securitize

LEH FI Research to help with market numbers

BNC vs. Competitors

BNC has been close to market average in overall mix of loan structures & borrower profiles

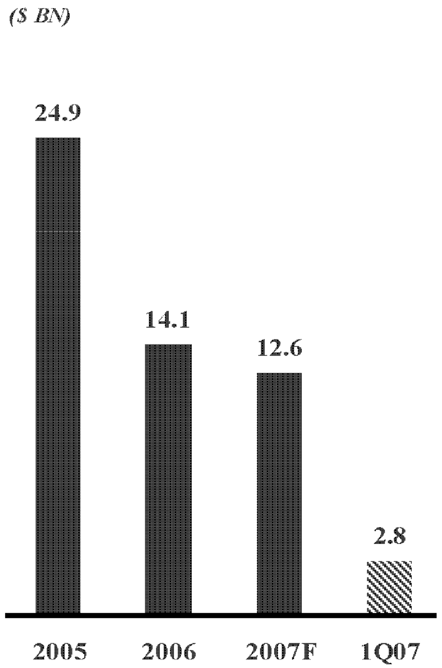
		2006 Lending Statistics	
		BNC	Market
Loan Structure	Interest Only	◆ 24%	◆ 20%
	80/20s	◆ 11%	◆ […]
	2nd Lien	◆ 2%	◆ […]
	Full Docs	◆ 56%	◆ […]
	40 / 50 Year	◆ 3%	◆ […]
Delinquency / Default	6 Mth Delinquency Rate	◆ […]	◆ […]
	FPD Rate	◆ […]	◆ […]
Borrower Characteristics	FICO	◆ 623	◆ 626
	CLTV	◆ 86%	◆ 86%
	DTI	◆ 42%	◆ 41%
	Non-Owner Occupied	◆ 7%	◆ [...]

2005 currently includes
FA and BNC

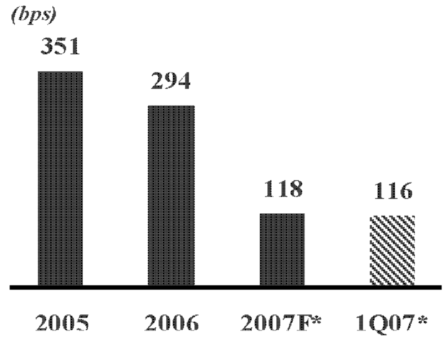
Evolution of BNC Economics

Deterioration in economics driven by decline in origination volumes, reduced gain on sale / securitization revenue from capital markets and rise in delinquencies

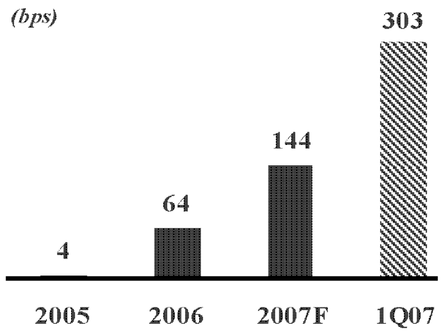
Origination volume is declining…



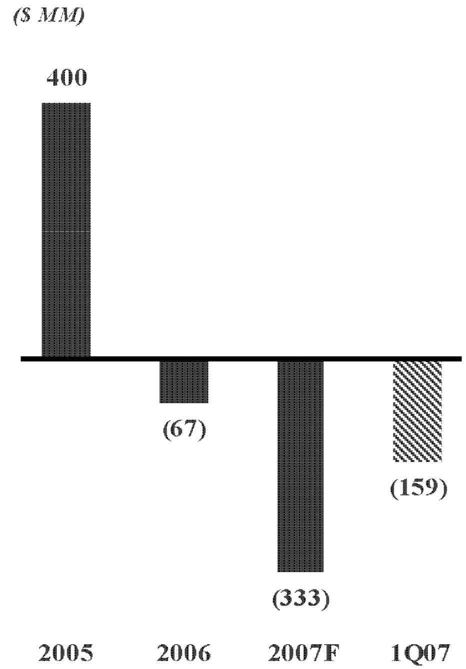
…as is the amount gained on sale / securitization…



…while loan loss reserves are increasing…



…resulting in lower pre-tax income



* *Assumes no gains on securitization for period.*

Commentary re: how this compares to competitors?

Balance Sheet Subprime Risk Exposure

Current subprime risk exposure has been managed well – but more difficult in future

Current Exposure

- Firm strategy to securitize and sell all loans into capital markets
  - Including residuals
  - Firm also actively hedges balance sheet positions, given need to mark-to-market
- Protected us, to date, from significant charge-offs that afflicted lenders with different approach e.g., HSBC
  - HSBC kept loans on balance sheet, with limited hedging
- Current subprime "economic" balance sheet $10.3B
  - Whole loans $8.6B
  - Securities $1.5B
  - Residuals $0.2B

Exposure Issues Going Forward

- Currently unable to securitize and sell to capital markets profitably
  - Balance sheet will increase ~$1B per month
    - Constrain Firm's ability to use balance sheet for other activities (Firm net Balance Sheet ~$300B)
- More difficult to hedge inventory positions
  - More costly to buy protection
  - More difficult to hedge effectively – correlations may not work as well
- Issues when capital market risk appetite returns
  - Absorption capacity will be limited given large build-up of inventories industry-wide
  - Particularly difficult to sell residuals - hedging correlations may not have been effective

Alternative / additional

BNC Started to Tighten Lending Criteria Early

[ ]

	1 H 2006	2 H 2006	1 H 2007
Risk evaluation process			
Credit criteria			
Loan size			
Other			

Recent and Planned Changes to the Business

Address immediate excess capacity and reconfigure for future success

New Leadership Team (late 2006)

- New CEO – Steve Skolnik
  - Ex-First Franklin
- New Head of Sales – Tim Owens
  - Ex-Option One
- New COO – Scott Anderson
  - Ex-Accredited

Reduction in Force

2006

- Reduced headcount by 23% (510 employees) vs. yr end 2005 levels
  - 55 Account Executives
  - 455 admin / ops staff

2007

- Additional 26% headcount reduction planned for May
  - 49 Account Executives
  - 372 admin / ops staff

Change in Operating Model (May 2007+)

- Convert from branch model (34 locations) to regional operational center model (8 locations)
- Align officer & account executive compensation to loan performance
- Migrate account executive production from correspondent to wholesale channel
- Double Ops staff efficiency by employing best practice file flows
- Continue to work with trading desk on new products and optimizing profitability of existing products

BNC uniquely positioned to succeed in future environment due to vertically integrated model, leadership team and planned operational / operating model changes

Likely Future BNC Origination Volumes

Expect $1 billion origination volumes: based on our lending criteria / pricing & the evolving market and competitive environment

Market and Competitive Environment

- 2007 origination volumes expected to be ~30% lower than 2006:
  - Forecast: $650B→ $450B(1)
  - Lenders more restrictive
  - Housing bubble dissipated
  - But significant number of ARM resets due in 2007 and 2008
- Some excess capacity reduced
  - Some independents go out of business
  - Other independents bought & expected to cut back

Scenario A: (expected)	Scenario B:	Scenario C:
Many competitors exit / cut back	Some capacity reduced through exits & cutbacks	Competitors purchased / stay in business, volumes maintained
Originations: ◆ $1B monthly ◆ Est. 2.7%(2) market share	Originations: ◆ $750MM monthly ◆ Est. 2.0%(2) market share	Originations: ◆ $500MM monthly ◆ Est. 1.3%(2) market share
	Eliminate: 53 additional jobs 3 locations	Eliminate: 152 additional jobs 4 locations

(1) *Assumes House Price Appreciation of 0% in 2007*
(2) *Lehman Brothers' total subprime market share in 2006 was approximately 2.2%*

Run Rate Financials – Scenarios

2007 Projections

Monthly Production Volume ($MM)

($ in millions)

Capital Markets / Default Scenarios			$1,000	$750	$500
Scenario 1: Better Prospects	◆ Capital markets: able to securitize and sell whole loans into market ◆ Historical – non-bubble level of defaults	Revenue	$336.0	$252.0	$168.0
		Pre-Tax Income	$81.6	$41.4	$7.8
		Pre-Tax Margin	24.3%	16.4%	4.6%
Scenario 2: Partial Recovery	◆ Capital markets: greater ability to securitize Moderate level of defaults	Revenue	$276.0	$207.0	$138.0
		Pre-Tax Income	($2.4)	($21.6)	($34.2)
		Pre-Tax Margin	(0.9%)	(10.4%)	(24.8%)
Scenario 3: Difficult Market	◆ Capital markets: continued limited ability to securitize ◆ High defaults continue	Revenue	$216.0	$162.0	$108.0
		Pre-Tax Income	($86.4)	($84.6)	($76.2)
		Pre-Tax Margin	(40.0%)	(52.2%)	(70.6%)

Current expectations for 2008 assume scenario 1. However, if scenario 1 is not realized, additional adjustments will be required.

OpCo or One P&L?

More simple alternative

Run Rate Financials – Scenarios

Three scenarios modeled based on monthly production volume of $1 billion

Capital Markets / Default Scenarios		2007 Projections *($ in millions)*		
		Revenue	**Pre-Tax Income**	**Pre-Tax Margin**
Scenario 1: Better Prospects	◆ Capital markets: ability to securitize and sell residuals into market ◆ Historical – non-bubble level of defaults	**$336.0**	**$81.6**	**24.3%**
Scenario 2: Partial Recovery	◆ Capital markets: greater ability to securitize ◆ Moderate level of defaults	**$276.0**	**($2.4)**	**(0.9%)**
Scenario 3: Difficult Market	◆ Capital markets: continued limited ability to securitize ◆ High defaults continue	**$216.0**	**($86.4)**	**(40.0%)**

Current expectations for 2008 assume scenario 1. However, if scenario 1 is not realized, additional adjustments will be required.

OpCo or One P&L?

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Limited Contagion To Related Markets

- Alt-A / Alt-B Mortgages
  - Credit performance not problematic – delinquencies are within expected range
  - Greater risk of subprime impacting house prices negatively, which in turn would reduce origination volumes in Alt-A / Alt-B and Prime
  - [Comment on Aurora's expected business performance]

- UK subprime
  - Less mature market than US
    - Loan terms & pricing currently less aggressive, but competition is intensifying – may put pressure on the economics of Lehman's business in the short term
  - Delinquency and default rates lower than US
  - House price appreciation higher & more evenly distributed – supported by fundamental housing shortage

- ABS CDOs
  - Existing market losses are manageable
  - Outlook for further originations is questionable in near term
  - [Comment on Lehman's expected business performance]

- Commercial paper

Summary and Planned Next Steps

- Most of large subprime independents have gone out of business, have been sold or are selling

- But subprime market is here to stay
  - Meets a clear need from households
  - Profitability will return when environment improves
    - Lending standards tighten, pricing improves & excess capacity is removed – starting to see this
    - Outlook is stable enough for the return of capital markets' appetite to purchase subprime loans

- Lehman's subprime business: pre-tax income forecast of $(330)MM for 2007
  - Have taken and planning to take further corrective action to the business
    - New leadership team in place
    - Tightened lending standards, increased pricing – loan loss provisions will come down after Q1
    - Reduction in headcount & locations, and changes to operating model
  - Scenarios developed for different levels of origination volume
  - Plan predicated on capital markets' willingness to buy subprime loans in late 2007 or early 2008
    - Pre-tax margin expected to return to 20+%
    - If capital markets' appetite does not return, will need to revisit options

Appendices

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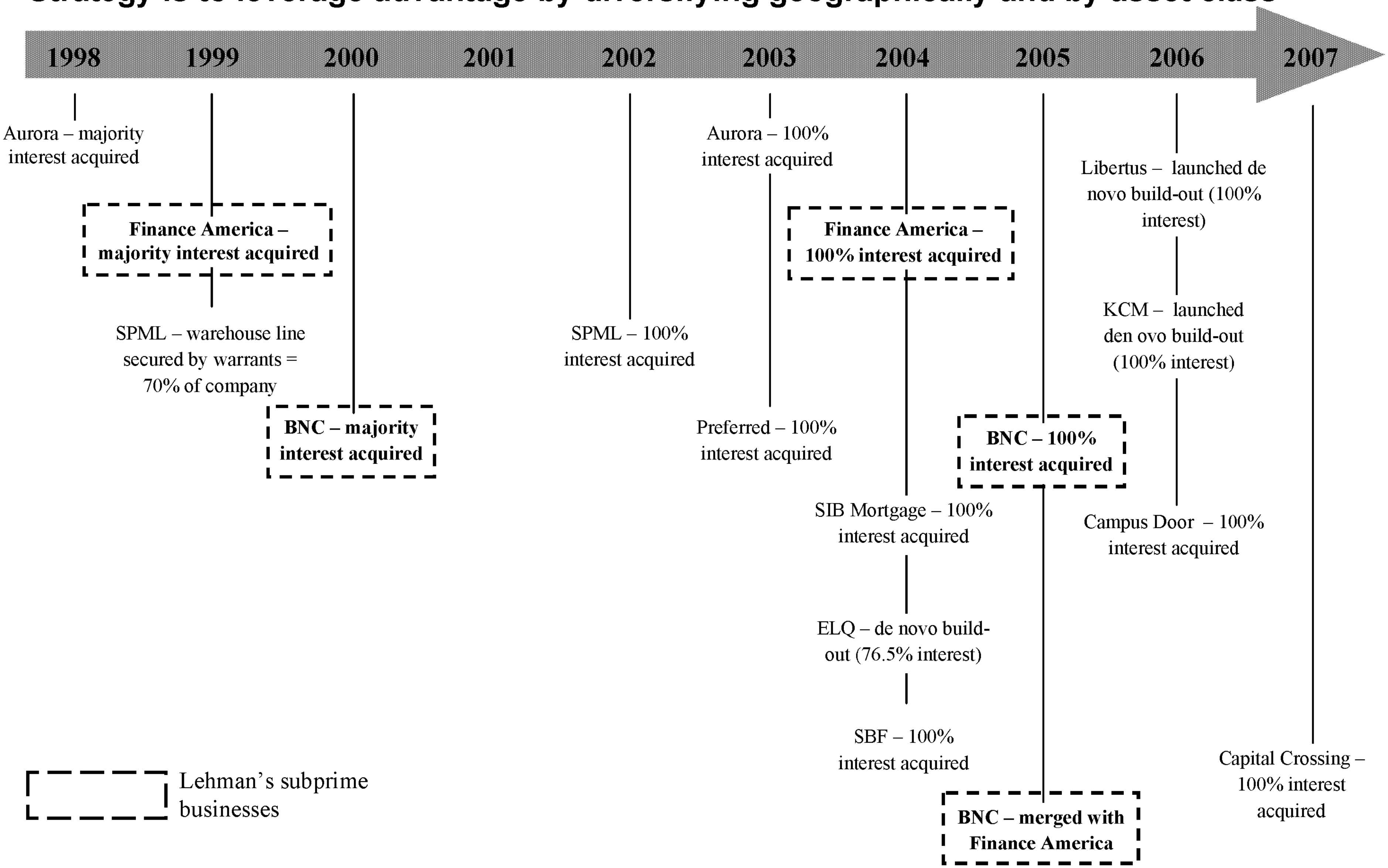
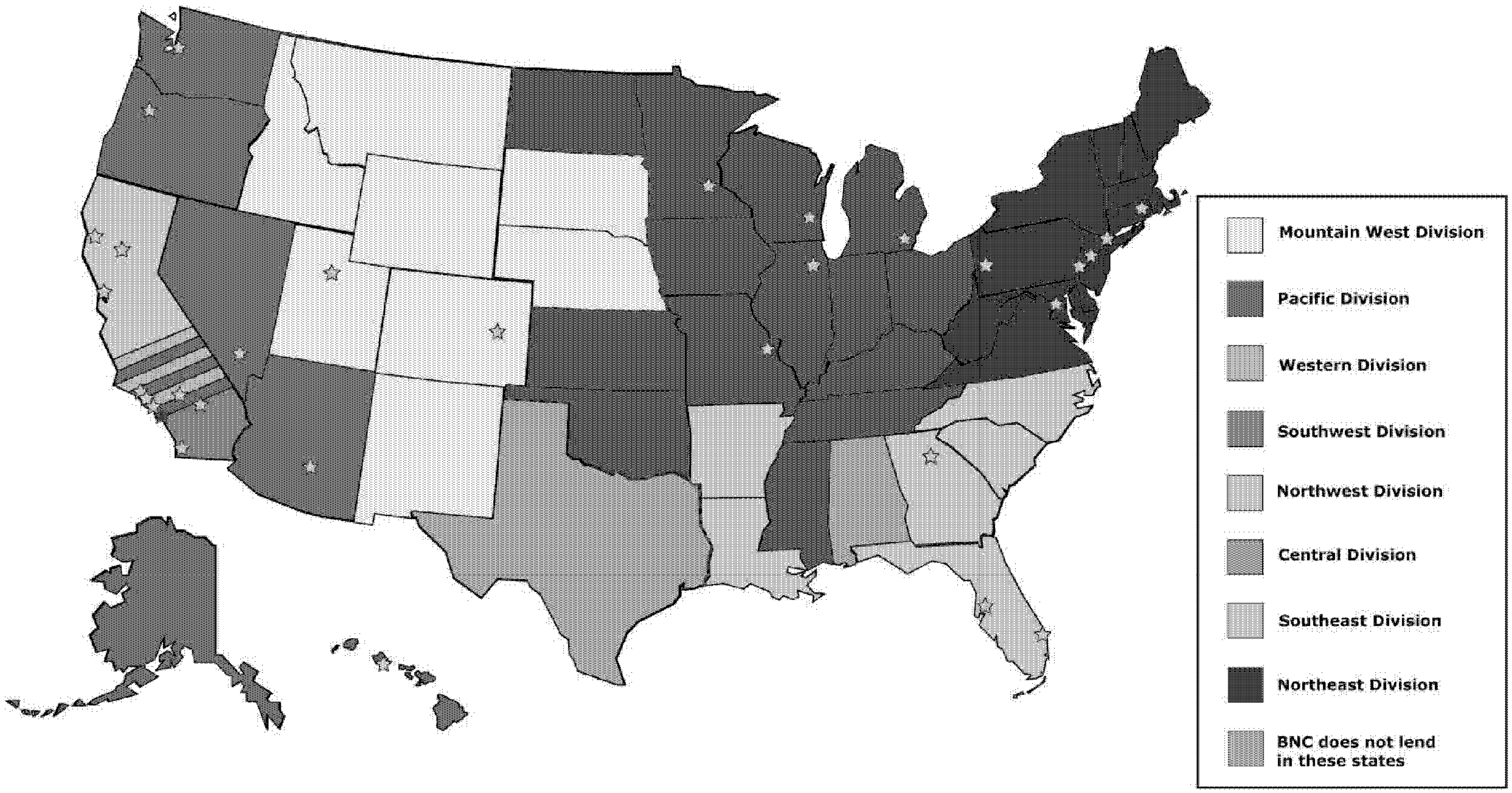
MCD Acquisition / New Business History

Strategy is to leverage advantage by diversifying geographically and by asset class



Current Decentralized Model



☆ BNC Branches

★ **Irvine, CA**
BNC Corporate

-- East / West Divide

Arizona
Tempe

California
Campbell
Corona
Concord
Covina
Glendale
Long Beach
Orange County
Roseville
Sacramento
San Diego
South Bay
San Ramon
Woodland Hills

Colorado
Denver

Connecticut
Hartford

Florida
Sunrise
Tampa

Georgia
Atlanta

Hawaii
Honolulu

Illinois
Downers Grove

Maryland
Baltimore

Michigan
Detroit

Minnesota
Roseville

Missouri
St. Louis

New Jersey
Florham Park

Nevada
Las Vegas

New York
Melville

Oregon
Lake Oswego

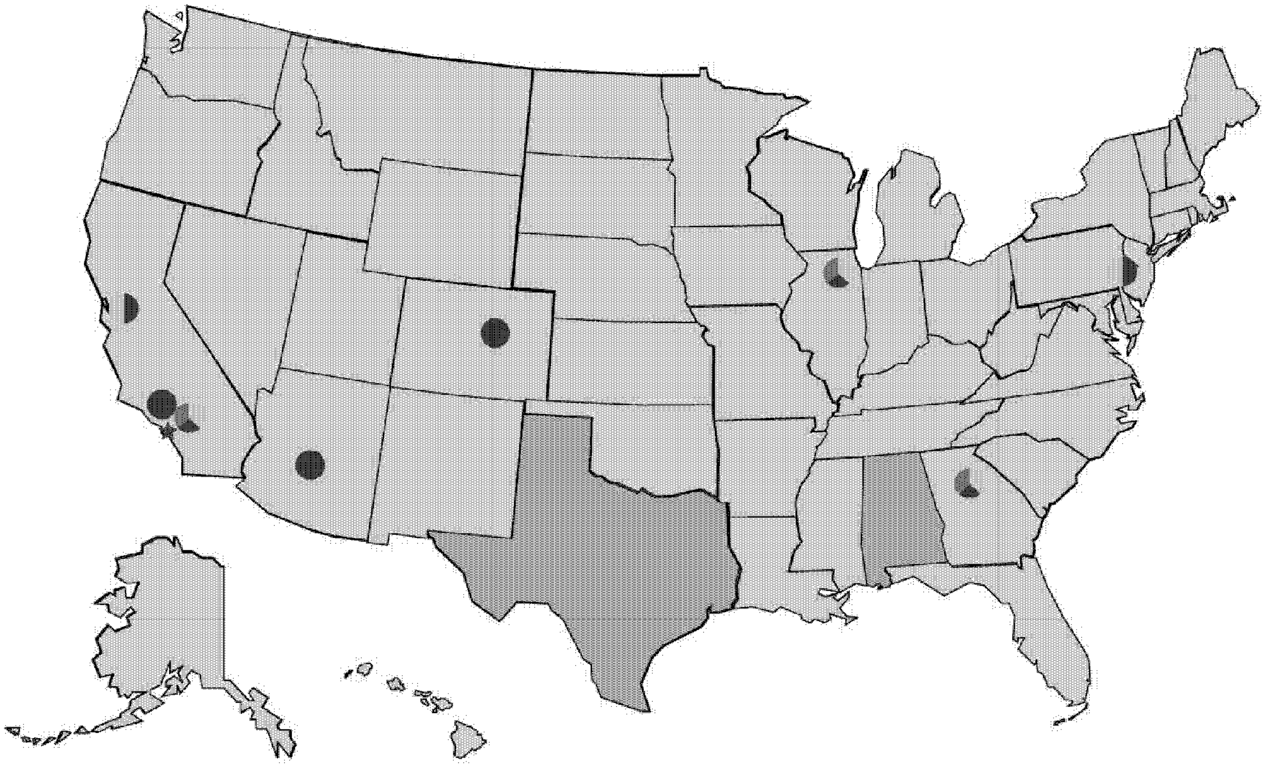
Pennsylvania
Pittsburg
Philadelphia

Utah
Salt Lake City

Washington
Seattle

Wisconsin
Milwaukee

Proposed Regional Operating Centers



★ **Irvine, CA**
BNC Corporate

BNC does not lend in these states

$1 Billion

Arizona
Tempe

California
Orange County/Riverside
Concord
Los Angeles

Colorado
Denver

Georgia
Atlanta

Illinois
Chicago

Pennsylvania
Philadelphia

$750 Million

California
Orange County/Riverside
Concord

Georgia
Atlanta

Illinois
Chicago

Pennsylvania
Philadelphia

$500 Million

California
Orange County/Riverside

Illinois
Chicago

Georgia
Atlanta