DRAFT

***Confidential* Presentation to:**

Executive Committee

Equity Adequacy

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Executive Summary

- Supporting capital adequacy is one of the key objectives of our capital management. Our strategy is to achieve the level of capital adequacy consistent with regulatory requirements, rating agencies targets, internal risk-based requirements, and peer benchmarking. To evaluate our capital position, we use a set of measures reflecting different aspects of capital adequacy

- According to all measures, in the last 5-6 quarters, our capital adequacy has materially deteriorated
  - Net Leverage increased by 3 turns, although remains within the peer group range
  - Tier 1 Capital Ratio and Total Capital Ratio (CSE measures) are below internal targets and there is a credible intelligence that we are at the bottom of the peer range. This is particularly relevant since the ratios will be publicly disclosed beginning Q1'08
  - Equity Sufficiency (Equity Adequacy Framework) is in deficit (from $7.2B surplus in Q1)

- The primary driver behind this deterioration is a shift in our asset mix, specifically rapid growth of our HY positions (including commitments), Real Estate, and Principal investments
  - These less-liquid positions disproportionally increase capital requirements through Reg Y (CSE model) and Less-Liquid charges (EAF model)
  - With asset composition unchanged, 2008 budget projections indicate further deterioration of the capital adequacy

- At present, our ability to increase supply of available equity capital is restrained
  - Based on rating agencies guidelines, we have exhausted our capacity for issuing hybrid equity. Although we still have room to issue hybrids based on CSE guidelines, the impact on CSE Capital Ratios will be de-minimis. Further, near-term market appetite for such securities is quite limited
  - We can slow down or eliminate stock buybacks in Q1'08. This may increase T1 Ratios by 0.4-0.7 turns, however not enough to bring the ratios within the target range. The benefits of this strategy need to be weighed against negative dilution and signaling effects

- To bring our capital adequacy within the target range, the asset mix needs to be adjusted
  - High Yield positions (Reg Y) reduced from X to Y
  - Less Liquid Positions reduced from M to N