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Subject: S&P NEW ISSUE REPORT ON FREEDOM NOTES / CLO
Attach: 04.11.08 Freedom CLO.pdf

Jim

Attached please find an S&P report published today (around 2:30) on the Freedom trade, and a copy of the related WSJ article is also below for your files.

The 3 main concerns the agency highlights:

- 1) no collateral manager; sub holders can direct the sale
- 2) all LEH positions from our books
- 3) significant (and they give the %'s) of principal amounts that are cov-lite, bridge loans, and CCC/NR (and the NR's were analyzed as having a CCC- rating).

Thanks
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WSJ(4/11) Lehman Deal Takes Advantage Of New Lending Facility 2008-04-10 23:09 (New York)

(From THE WALL STREET JOURNAL)
By Serena Ng and Susanne Craig
Financial engineering helped get Wall Street into its current credit-market problems. Now, Wall Street's Lehman Brothers Holdings Inc. is using a little engineering -- and some help from the U.S. Federal Reserve -- to bolster its finances.

In recent weeks, Lehman moved \$2.8 billion in loans, including some risky leveraged-buyout debt that has been difficult to sell, into a newly created investment vehicle it named "Freedom," which in turn issued debt securities backed by the loans.

About \$2.26 billion of the securities received investment-grade credit ratings from Moody's Investors Service and Standard & Poor's. Lehman then pledged some of the securities as collateral for a low-interest, short-term cash loan from the Federal Reserve, according to people familiar with the matter.

The result for Lehman: By repackaging unsold debt and turning to the Fed's new borrowing facility, it was able to turn loans that had been mostly shunned by investors for months into cash it could use to finance its business.

Fed officials had worried in the early stages of the credit crisis that banks would be worried about the stigma of borrowing directly from the central bank.

But use of the Fed borrowing facility has been robust.

The Lehman deal shows how some of the issues brought to light by the credit crunch -- such as the market's dependence on credit-rating firms and Wall Street's affection for complex investment structures -- are still very much a part of market activity.

"The loss of confidence in structured-finance ratings is at the heart of the current market crisis," said Ed Grebeck, chief executive of Tempus Advisors, a debt-strategy firm. "For investment banks to go back to the ratings firms and say, 'Here's a new structure for you to rate investment grade' -- that's shocking to me."

A spokesman for the Federal Reserve Bank of New York said it doesn't comment on the collateral it takes on individual loans.

Bundled Up

Last month, after a liquidity crisis nearly caused the collapse of Bear Stearns Cos., the Fed introduced a new lending facility for investment banks that would give them more ways to borrow against their holdings. Called the Primary Dealer Credit Facility, it accepts a range of securities as collateral for cash loans that can be rolled over daily. Among other things, the securities pledged by dealers must have market prices and "investment grade" credit ratings.

As of the end of February, Lehman held \$17.8 billion in leveraged loans.

These are typically issued to companies that have below-investment-grade, or junk, credit ratings and were commonly used to finance leveraged buyouts. The market prices of such loans have dropped significantly from levels nine months ago.

Unlike commercial banks, which can use loans as collateral for borrowing from a different Fed borrowing facility, called the discount window, securities dealers and investment banks can pledge only securities, not individual loans.

Lehman's Freedom vehicle is commonly called a collateralized loan obligation, or CLO, on Wall Street. CLOs are securities backed by a pool of loans. Freedom bundled together more than 60 of Lehman's loans and divided up the risk by issuing two groups of securities, which Lehman kept.

One group of securities, valued at \$565 million, wasn't rated and was structured to bear the first 20% of losses among the \$2.83 billion in loans in the pool. The other group, comprising \$2.26 billion in securities, was assigned an "A" rating by credit-rating services because

the debt pool would need to lose more than 20% before these securities suffered losses.

Was It 'Brilliant'?

One person familiar with the matter said the vehicle was named Freedom because it was designed to give Lehman freedom to tap as much cash as possible if needed. The size of the borrowing from the Fed wasn't known, but the person said it wasn't "material" and was meant as a test of what the Fed would accept.

The loans in the pool included debt that was issued to finance last year's leveraged buyouts of First Data Corp. and TXU Corp., a person familiar with the matter said.

A number of Wall Street executives called Lehman's move "brilliant" and said they may follow suit. One senior finance executive at a rival of Lehman's said his main reservation with Lehman's move was that it might lead to criticism that Wall Street is taking its junk to the Fed for cash. Still, he noted that unlike many troubled mortgage securities, there is a discernible market for leveraged loans.

"It's a very creative way for investment banks to get liquidity from assets that they don't want to sell at fire-sale prices," said Todd Kesselman, managing director of Precision Capital, an investment-advisory firm that specializes in structured credit and private equity.

Firms are finding other ways to unload corporate loans that have piled up on them. Citigroup Inc., for example, is close to selling \$12 billion of its leveraged loans to a group of private-equity firms for about 90 cents on the dollar.

Since the summer, when many parts of the credit market seized up, banks and Wall Street firms have been stuck holding hundreds of billions of dollars of loans, bonds, and complex securities backed by mortgages and other assets. The banks created the debt with the intention of selling it to investors for handsome fees.

When many investors backed away from riskier debt last year, banks were forced to keep the debt, which has strained their ability to trade or to make new loans. Liquidity in the market dried up as a result.

To encourage firms to trade more freely with each other, the Fed has taken a series of unprecedented steps to boost liquidity in the markets, including expanding its direct lending to securities dealers. So far, the Fed's measures have helped alleviate some of the strains in the credit markets.

(END) Dow Jones Newswires

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