

LEHMAN BROTHERS

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LEHMAN BROTHERS

I

Executive summary

Complex Derivatives Transaction Review Committee

This committee, consisting of Capital Market Finance, Accounting Policy and Model Validation personnel, was set up in April 2005 and meets to consider any significant derivative transactions undertaken. The committee considers whether the transactions are being booked, valued and modeled appropriately. Furthermore, the committee determines whether the proper accounting treatment is being applied. During the month, the following transactions were reviewed:

- *Partial Principal Protection on Subprime Fund* – Exum is an issuer of synthetic CDO notes with Lehman being the swap counterparty. Exum issued funded and unfunded notes in 16 deals; funded notes totaled \$1.1 billion. The funded amounts are invested in a subprime fund managed by Lehman Brothers Asset Management. Lehman is also providing protection between specified percentages of the principal in the subprime fund investment. Based on discussions between Front Office, Quant Research and Product Control, the value of the partial principal protection will be estimated based on: 1) series of potential terminal values of the subprime fund and 2) probabilities of each of the potential terminal values. This is similar to recognizing a loss on the full protection amount less the value of a call option. This partial principal protection will be classified as level 3 under FAS157 since implied volatility is deemed to be unobservable.
- *Liquidity Adjustment on Restricted Equity* – Cerberus holds between 80% and 85% of the total shares outstanding of Aercap. Lehman has participation rights in approximately 2.7% of Cerberus's investment. Aercap shares are publicly traded. However, Lehman owns participation rights and not the shares directly. Therefore, Lehman's equity holding in Aercap is restricted. This restriction and the relative size of Cerberus's investment in Aercap limit Lehman's ability to realize the full market value. As such, a liquidity adjustment is required for Lehman's participation rights. A proxy for this liquidity adjustment amount will be the premium of an at-the-money put option.
- *FX Option Range Accrual Trade* – Lehman entered into a FX option range accrual trade, paying 7.182% and receiving 6.382% plus 9% on the proportion of days that both the current spot and one-year prior spot USD/JPY rates are below 92. The trade matures in 10 years and has an initial notional of CNY 600 million that declines to CNY 550 million over the life of the trade. Lehman is expected to be the net payer in the first four years and the net receiver subsequently. As such Lehman is short CNY in the first four years and long CNY in subsequent years. Based on interest rate parity, the implied CNY interest rate curve has negative interest rates up to the 4-year point. These negative interest rates are due to the spot USD/CNY rate being pegged rather than freely floating and the market views that the peg will eventually be broken or widened. The trade is booked in MPGX, and the negative implied interest rates are causing system issues. As such, MPGX cannot generate a market value for the trade. The desk has proposed to replace the negative interest rates with 0.25%. The committee concluded that this methodology would generate an aggressive P/L since it artificially depreciates the value of CNY in the period that Lehman is the net payer (i.e., the first four years). Product Control will discuss modeling issues with Quant Research and Model Validation, and determine whether it is appropriate to hold back P/L.

Executive summary

Valuation adjustments (decreased by \$41mm from \$2,398mm to \$2,357mm, as detailed in section 2)

Significant changes include:

- Increase of \$55mm of Counterparty adjustment from Securitized Products Americas is attributable to increase in MTM on credit protections purchased from ACA Capital and Assured Guaranty.
- Decrease of \$47mm of Contractual Early Termination adjustment from Capital Markets Funds Joint Venture is mainly due to transfer of valuation adjustments from FID to Equities Division.
- Decrease of \$26mm of Deal Review adjustment from CDO Europe relates to P/L holdback from new trades pending deal review.
- Decrease of \$13mm of Model Fit adjustment from GPS Europe is attributable to adjustments for incorrect marks.

Price verification projects (further details in section 3)

In recent months, the Valuation and Control group:

- Initiated price testing of portfolio of Eagle Energy Partners
- Initiated price testing of heat rate options and distillates
- Increased FX skew testing coverage from 60% to 90%, submitted a total of 57 currency pairs (as well as local pairs from Europe and Asia) to outside pricing service and standardized methodology amongst global centers
- Initiated price testing of CMS spread options and CMS caps / floors
- Initiated price testing of FX cross volatilities; working on establishing variance thresholds
- Initiated output price testing with Totem on: FX FVA, FX barrier options and digital CMS options
- Initiated futures and ishares price testing for hedge fund replication business in IRP

The group is currently working on the following improvements:

- Increase brokerage coverage
- Enable full re-pricing of cap / floor skew positions with Totem results
- Expand Totem submission on FX exotics, such as baskets
- Establish price testing methodology for BMA swaptions
- Establish Totem submissions & price testing for Bermudan options
- Establish deal review processes for exotic interest rate derivatives, fund derivatives and mortgage derivatives
- Continue to improve testing of mortgage derivatives as well as skew on mortgage options
- Transfer FX skew and energy price testing processes to India

Executive summary

Significant points on price verification (as detailed in section 3)

- Aggregate significant variance of \$58 million on the aggressive side, of which Americas is \$33 million on the aggressive side (re-marks of -\$23 million), Europe is \$15 million on the aggressive side (re-marks of -\$8 million) and Asia is \$10 million on the aggressive side (re-marks of -\$6 million).
- There are \$53 million of conservative significant variances attributable to Real Estate Americas. PCG concluded that these variances are reasonable considering that most positions are concentrated and illiquid.
- There are \$35 million of aggressive significant variances attributable to CDO Americas. These variances are attributable to ABS CDO positions. The desk is in the process of re-marking these positions and will provide support for their marks to PCG subsequently.
- There are \$18 million of aggressive significant variances attributable to Bank Loans Americas. These variances have been resolved through: 1) re-marking, 2) PCG concluding that variance is due to size of position or 3) PCG concluding that variance is due to lack of liquidity of position and/or volatile market conditions.
- There are \$18 million of aggressive significant variances attributable Securitized Products Americas. These variances are attributable to reconstituted NIMs and residuals. PCG concluded that desk prices fell within stressed base case assumptions.

Significant Pricing Variance - Global FID in \$'000

| | <u>Re-marked</u> | <u>Resolved</u> | <u>Total</u> |
|--------------|------------------|-----------------|-----------------|
| Level 1 | 946 | 0 | 946 |
| Level 2 | (37,810) | (76,631) | (114,441) |
| Level 3 | 0 | 55,785 | 55,785 |
| Total | (36,864) | (20,846) | (57,710) |

*Definition of pricing levels:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at measurement date.

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly. This includes quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active. Additionally inputs other than quoted prices that are observable for the asset or liability (eg interest rate and yield curves, observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks and default rates). Inputs that are derived principally from or corroborated by other means.

Level 3: Unobservable inputs for the asset or liability.

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Valuation Adjustments

December 2007



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VALUATION ADJUSTMENTS – significant changes

| Region | Product | Description | Type | Current Month | Prior Month | Change | Comment |
|---------------------------------|--|--|---------------|------------------|------------------|-----------------|---|
| Americas | Securitized Products | ABS - Counterparty Credit Adjustments | Credit | 526,855 | 471,873 | 54,982 | Increase is due to increase in MTM on credit protections purchased from ACA Capital and Assured Guaranty. |
| Europe | Capital Markets Funds Joint Venture | Contractual Early Termination Valuation Adjustments | Risk Transfer | 87,226 | 133,864 | (46,638) | Decrease is due to transfer of valuation adjustment from FID to Equities Division. |
| Europe | CDO | P&L Pending Deal Review | Risk Transfer | (14,429) | 12,019 | (26,448) | Decrease is due to new deals pending deal review. |
| Europe | GPS | Model - Fit | Model | (6,404) | 6,775 | (13,179) | Decrease is due to adjustments for incorrect marks. |
| Subtotal | | | | 593,248 | 624,531 | (31,283) | |
| Remaining Valuation Adjustments | | | | 1,763,566 | 1,773,054 | (9,487) | |
| Total Valuation Adjustments | | | | <u>2,356,814</u> | <u>2,397,585</u> | <u>(40,770)</u> | |

VALUATION ADJUSTMENTS – summary

| Business | Total \$000 | Contingent | | | | | Risk | | Valuation |
|--|------------------|----------------|----------------|----------------|----------------|----------------|---------------|----------------|---------------|
| | | Model | Bid/Offer | Liabilities | Liquidity | Credit | Expense | Transfer | |
| Liquid Market Prop | 5,081 | - | 5,081 | - | - | - | - | - | - |
| Interest Rate Products | 457,682 | 192,914 | 80,694 | - | 25,059 | 15,662 | - | 108,563 | 34,790 |
| Foreign Exchange | 18,647 | (5,862) | 14,882 | - | - | - | - | 3,085 | 6,542 |
| High Grade Credit | 50,701 | (4,910) | 43,812 | 5,203 | 4,194 | 1,456 | 1,001 | (55) | - |
| CDO | 709,218 | 151,055 | 86,220 | 76,321 | 111,912 | 278,250 | 9,347 | (4,722) | 835 |
| High Yield | 41,244 | (1,000) | 36,451 | 1,000 | - | - | 4,225 | - | 568 |
| Real Estate | (10,841) | - | - | - | - | - | 66 | - | (10,907) |
| Munis | 67,074 | 696 | 6,179 | - | - | 54,403 | - | 3,599 | 2,197 |
| Securitized Products | 907,111 | - | 39,736 | 302,723 | - | 536,632 | 27,906 | - | 114 |
| Commodities Trading | 84,403 | 10,058 | 43,215 | - | 5,530 | 12,100 | - | - | 13,500 |
| FID Corporate | 26,494 | 528 | 20,755 | - | - | - | - | 5,211 | - |
| Total FID Valuation Adjustments | 2,356,814 | 343,479 | 377,025 | 385,247 | 146,695 | 898,503 | 42,545 | 115,681 | 47,640 |

VALUATION ADJUSTMENTS – Regional matrix

| America | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|------------------------|------------------|----------------|----------------|------------------------|----------------|----------------|---------------|----------------|---------------|
| Liquid Markets Prop | 4,498 | - | 4,498 | - | - | - | - | - | - |
| Interest Rate Products | 85,607 | 61,659 | 9,881 | - | 6,155 | 7,912 | - | - | - |
| Foreign Exchange | 23,807 | 10,204 | 11,093 | - | - | - | - | 2,949 | (439) |
| High Grade Credit | 39,764 | 554 | 34,226 | - | 3,794 | 1,043 | 147 | - | - |
| CDO | 315,646 | 15,289 | 2,982 | 9,873 | - | 278,250 | 9,252 | - | - |
| High Yield | 29,442 | (1,000) | 29,442 | 1,000 | - | - | - | - | - |
| Real Estate | (10,907) | - | - | - | - | - | - | - | (10,907) |
| Munis | 67,074 | 696 | 6,179 | - | - | 54,403 | - | 3,599 | 2,197 |
| Securitized Products | 883,770 | - | 39,736 | 284,375 | - | 535,764 | 23,781 | - | 114 |
| Commodities Trading | 50,500 | - | 24,900 | - | - | 12,100 | - | - | 13,500 |
| FID Corporate | 6,205 | - | 6,205 | - | - | - | - | - | - |
| Total America | 1,495,406 | 87,402 | 169,142 | 295,248 | 9,949 | 889,472 | 33,180 | 6,548 | 4,466 |
| Europe | | | | | | | | | |
| Capital Mkts Fund JV | 113,388 | 14,466 | 11,696 | - | - | - | - | 87,226 | - |
| Liquid Markets Prop | 583 | - | 583 | - | - | - | - | - | - |
| Interest Rate Products | 199,999 | 75,803 | 50,865 | - | 17,204 | - | - | 21,337 | 34,790 |
| Foreign Exchange | (5,186) | (16,066) | 3,763 | - | - | - | - | 136 | 6,981 |
| Commodities Trading | 32,858 | 10,058 | 17,270 | - | 5,530 | - | - | - | - |
| High Grade Credit | 5,604 | (6,404) | 6,805 | 5,203 | - | - | - | - | - |
| High Yield Credit | 4,914 | - | 4,346 | - | - | - | - | - | 568 |
| CDO | 393,297 | 135,766 | 83,184 | 66,448 | 111,912 | - | - | (4,722) | 709 |
| Securitized Products | 18,348 | - | - | 18,348 | - | - | - | - | - |
| FID Corporate | 16,912 | 528 | 11,173 | - | - | - | - | 5,211 | - |
| Total Europe | 780,717 | 214,151 | 189,685 | 89,999 | 134,646 | - | - | 109,188 | 43,048 |
| Asia | | | | | | | | | |
| Interest Rate Products | 58,688 | 40,986 | 8,252 | - | 1,700 | 7,750 | - | - | - |
| High Grade Credit | 5,333 | 940 | 2,781 | - | 400 | 413 | 854 | (55) | - |
| CDO | 275 | - | 54 | - | - | - | 95 | - | 126 |
| Foreign Exchange | 26 | - | 26 | - | - | - | - | - | - |
| High Yield Credit | 6,888 | - | 2,663 | - | - | - | 4,225 | - | - |
| Real Estate | 66 | - | - | - | - | - | 66 | - | - |
| Securitized Products | 4,993 | - | - | - | - | 868 | 4,125 | - | - |
| Commodities Trading | 1,045 | - | 1,045 | - | - | - | - | - | - |
| FID Corporate | 3,377 | - | 3,377 | - | - | - | - | - | - |
| Total Asia | 80,691 | 41,926 | 18,198 | - | 2,100 | 9,031 | 9,365 | (55) | 126 |
| Global Total | 2,356,814 | 343,479 | 377,025 | 385,247 | 146,695 | 898,503 | 42,545 | 115,681 | 47,640 |

LEHMAN BROTHERS

VALUATION ADJUSTMENTS – Americas

| America - Valuation Adjs | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|---|----------------|---------------|---------------|------------------------|--------------|----------------|--------------|---------------|--------------|
| LIQUID MARKETS PROP | 4,498 | 0 | 4,498 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bid/Offer Adjustment | 3,904 | | 3,904 | | | | | | |
| FX Prop Bid/Offer Adjustment | 594 | | 594 | | | | | | |
| FID DERIVATIVES | 85,607 | 61,659 | 9,881 | 0 | 6,155 | 7,912 | 0 | 0 | 0 |
| Liquidity Adjustment | 6,155 | | | | 6,155 | | | | |
| Option Model Adjustment | 29,499 | 29,499 | | | | | | | |
| CVA | 7,912 | | | | | 7,912 | | | |
| Spread Bid/Offer | 3,450 | | 3,450 | | | | | | |
| Volatility Bid/Offer | 6,431 | | 6,431 | | | | | | |
| Deal Specific | 32,160 | 32,160 | | | | | | | |
| FOREIGN EXCHANGE | 23,807 | 10,204 | 11,093 | 0 | 0 | 0 | 0 | 2,949 | (439) |
| Bid/Offer | 11,093 | | 11,093 | | | | | | |
| BRL On-shore / off-shore reserve | 318 | | | | | | | | 318 |
| FX Deal Specific - Model | 10,204 | 10,204 | | | | | | | |
| FX Deal Specific - Early Termination Adjustment | 2,949 | | | | | | | 2,949 | |
| Skew - Local Markets | (224) | | | | | | | | (224) |
| Skew - FX Options | (533) | | | | | | | | (533) |
| HIGH GRADE CREDIT | 39,764 | 554 | 34,226 | 0 | 3,794 | 1,043 | 147 | 0 | 0 |
| Bid/Offer Credit US | 20,808 | | 20,808 | | | | | | |
| Bid/Offer Latin | 3,284 | | 3,284 | | | | | | |
| Other Adjustment - Latin | 10,688 | 554 | 10,134 | | | | | | |
| Deal Specific Adjustment (Liquidity) - Latin | 3,941 | | | | 3,794 | | 147 | | |
| Credit Adjustment | 1,043 | | | | | 1,043 | | | |
| CDOs | 315,646 | 15,289 | 2,982 | 9,873 | 0 | 278,250 | 9,252 | 0 | 0 |
| Expense Adjustment | 9,252 | | | | | | 9,252 | | |
| Contingent Liability | 9,873 | | | 9,873 | | | | | |
| Counterparty Adjustment - ACA / XL | 278,250 | | | | | 278,250 | | | |
| Volatility Adjustment | 393 | | 393 | | | | | | |
| Bid / Offer | 2,589 | | 2,589 | | | | | | |
| Model Adjustment | 15,289 | 15,289 | | | | | | | |

VALUATION ADJUSTMENTS – Americas

| America - Valuation Adjs | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|---|------------------|----------------|----------------|------------------------|--------------|----------------|---------------|---------------|-----------------|
| HIGH YIELD | 29,442 | (1,000) | 29,442 | 1,000 | 0 | 0 | 0 | 0 | 0 |
| Tax Indemnity Adjustment (ANC) | 1,000 | | | 1,000 | | | | | |
| CDS Bid Offer (FID Corp Loans) | 7,684 | | 7,684 | | | | | | |
| Bid/Offer - SCT/Bonds/Distressed | 21,758 | | 21,758 | | | | | | |
| Model | (1,000) | (1,000) | | | | | | | |
| REAL ESTATE | (10,907) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | (10,907) |
| CMBS | (10,206) | | | | | | | | (10,206) |
| PTG | (701) | | | | | | | | (701) |
| MUNIS | 67,074 | 696 | 6,179 | 0 | 0 | 54,403 | 0 | 3,599 | 2,197 |
| CDS Model Adjustment | 696 | 696 | | | | | | | |
| Counterparty Credit Adjustment | 54,403 | | | | | 54,403 | | | |
| New Business Timing Items for deals not closed | 3,599 | | | | | | | 3,599 | |
| Derivatives Bid/Offer | 6,179 | | 6,179 | | | | | | |
| Libor Discounting / MMD Rate Lock valuation adj | 448 | | | | | | | | 448 |
| DSRF Bid Valuation Adjustment | 1,038 | | | | | | | | 1,038 |
| Cornell DSRF Credit Reserve | 711 | | | | | | | | 711 |
| SECURITIZED PRODUCTS | 883,770 | 0 | 39,736 | 284,375 | 0 | 535,764 | 23,781 | 0 | 114 |
| SCOR - Counterparty Credit Adjustment (trigger event) | 2,500 | | | | | 2,500 | | | |
| CAT - Beazley Deal Adjustment (trigger event) | 2,445 | | | | | 2,445 | | | |
| PFG - Commitment fees adjustment until loan matures/securitization | 114 | | | | | | | | 114 |
| PFG - Deal expenses/Due Diligence | 350 | | | | | | 350 | | |
| PFG - Contingent Liabilities/Referral Fees | 7,300 | | | 7,300 | | | | | |
| ABS - Bid / Offer Adjustment | 35,396 | | 35,396 | | | | | | |
| ABS - Counterparty Credit Adjustment | 526,855 | | | | | 526,855 | | | |
| ABS - Deal Expenses/Due Diligence | 100 | | | | | | 100 | | |
| Non Prime - Home Express (MGIC insurance) | 17,042 | | | 17,042 | | | | | |
| Non Prime - Reps and Warranties | 93,098 | | | 93,098 | | | | | |
| Non Prime - FHA/VA recourse risk | 11,864 | | | 11,864 | | | | | |
| Non Prime - Deal expenses/Due diligence | 11,325 | | | | | | 11,325 | | |
| Prime - Deal expenses/Due diligence | 11,093 | | | | | | 11,093 | | |
| Other - Deal expenses/Due diligence | 913 | | | | | | 913 | | |
| ABS - Contingent Liability | 30,519 | | | 30,519 | | | | | |
| Loan loss adjustment | 1,504 | | | 1,504 | | | | | |
| Prime - Non economic residuals | 0 | | | 0 | | | | | |
| Agency Remies/Strips - Non economic residuals | 112 | | | 112 | | | | | |
| Non Prime - Bid / Offer Adjustment | 3,842 | | 3,842 | | | | | | |
| Prime - Bid / Offer Adjustment | 498 | | 498 | | | | | | |
| Prime - Reps and Warranties | 114,037 | | | 114,037 | | | | | |
| Mandatory Auction Adjustment | 4,659 | | | 4,659 | | | | | |
| PFR Credit Adjustment | 3,964 | | | | | 3,964 | | | |
| Non Prime - Reps and warranties on scratch and dent securitizations | 4,240 | | | 4,240 | | | | | |
| COMMODITIES TRADING | 50,500 | 0 | 24,900 | 0 | 0 | 12,100 | 0 | 0 | 13,500 |
| Bid / Offer | 24,900 | | 24,900 | | | | | | |
| Deal Specific - Tenaska | 13,500 | | | | | | | | 13,500 |
| Credit - Right Way Risk | 10,600 | | | | | 10,600 | | | |
| CVA | 1,500 | | | | | 1,500 | | | |
| Index Trading | 0 | | | | | | | | 0 |
| FID CORPORATE | 6,205 | 0 | 6,205 | 0 | 0 | 0 | 0 | 0 | 0 |
| CDO/SCT - Bid / Offer (range bounding) | 6,205 | | 6,205 | | | | | | |
| FID AMERICA TOTAL VALUATION ADJS | 1,495,406 | 87,402 | 169,142 | 295,248 | 9,949 | 889,472 | 33,180 | 6,548 | 4,466 |

VALUATION ADJUSTMENTS – Europe

| Europe - Valuation Adjs | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|--|----------------|----------------|---------------|------------------------|----------------|----------|----------|----------------|---------------|
| FID DERIVATIVES | 199,999 | 75,803 | 50,865 | 0 | 17,204 | 0 | 0 | 21,337 | 34,790 |
| Bid-offer : Correlation | 41,036 | | 41,036 | | | | | | |
| Bid-offer : Delta | 7,497 | | 7,497 | | | | | | |
| Bid-offer : Vega | 1,810 | | 1,810 | | | | | | |
| Contractual Early Termination Valuation Adjustment | 15,530 | | | | | | | 15,530 | |
| Counterparty Credit | 0 | | | | | 0 | | | |
| Funding Cost | 34,580 | | | | | | | | 34,580 |
| Model : Approximation | 2,397 | 2,397 | | | | | | | |
| Model : Barrier shift | 10,591 | 10,591 | | | | | | | |
| Model : Calibration | 2,396 | 2,396 | | | | | | | |
| Model : Fit | 37,937 | 37,937 | | | | | | | |
| Model : Skew | 15,523 | 15,523 | | | | | | | |
| Model : Unapproved model | 6,959 | 6,959 | | | | | | | |
| Non-Contractual Early Termination Valuation Adjustment | 5,807 | | | | | | | 5,807 | |
| Parameter Uncertainty | 17,204 | | | | 17,204 | | | | |
| Deal Specific - To be re-categorised (Gov't) | 210 | | | | | | | | 210 |
| Bid-offer : Delta (Gov't) | 522 | | 522 | | | | | | |
| COMMODITIES TRADING | 32,858 | 10,058 | 17,270 | 0 | 5,530 | 0 | 0 | 0 | 0 |
| Parameter Uncertainty | 5,530 | | | | 5,530 | | | | |
| Bid-offer : Delta | 17,270 | | 17,270 | | | | | | |
| Contingent Deal | 0 | | | 0 | | | | | |
| Counterparty Credit | 0 | | | | | 0 | | | |
| Model : Skew | 2,155 | 2,155 | | | | | | | |
| Model : Unapproved model | 7,903 | 7,903 | | | | | | | |
| CAPITAL MARKETS FUND DERIVATIVES JV | 113,388 | 14,466 | 11,696 | 0 | 0 | 0 | 0 | 87,226 | 0 |
| Bid-offer : Vega | 11,696 | | 11,696 | | | | | | |
| Contractual Early Termination Valuation Adjustment | 87,226 | | | | | | | 87,226 | |
| Model : Skew | 14,466 | 14,466 | | | | | | | |
| Parameter Uncertainty | 0 | | | | 0 | | | | |
| CDO | 393,297 | 135,766 | 83,184 | 66,448 | 111,912 | 0 | 0 | (4,722) | 709 |
| Bid-offer : Delta | 82,802 | | 82,802 | | | | | | |
| Bid-offer : Vega | 382 | | 382 | | | | | | |
| Contingent Deal | 16,268 | | | 16,268 | | | | | |
| Contingent Liability | 50,180 | | | 50,180 | | | | | |
| Counterparty Credit | 0 | | | | | 0 | | | |
| Funding Cost | 709 | | | | | | | | 709 |
| Model : Approximation | 34,222 | 34,222 | | | | | | | |
| Contractual Early Termination Valuation Adjustment | 319 | | | | | | | 319 | |
| Model : Calibration | 11,323 | 11,323 | | | | | | | |
| Model : Fit | 82,427 | 82,427 | | | | | | | |
| Model : Numerical Approximation | 0 | 0 | | | | | | | |
| Model : Skew | 794 | 794 | | | | | | | |
| Model : Unapproved model | 7,000 | 7,000 | | | | | | | |
| Non-Contractual Early Termination Valuation Adjustment | 9,388 | | | | | | | 9,388 | |
| Parameter Uncertainty | 93,922 | | | | 93,922 | | | | |
| P&L pending deal review | (14,429) | | | | | | | (14,429) | |
| Deal Specific - To be re-categorised | 0 | | | | | | | | 0 |
| Liquidity : Concentration | 17,990 | | | | 17,990 | | | | |

VALUATION ADJUSTMENTS – Europe

| Europe - Valuation Adjs | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|---|----------------|-----------------|----------------|------------------------|----------------|----------|----------|----------------|---------------|
| HIGH GRADE CREDIT | 5,604 | (6,404) | 6,805 | 5,203 | 0 | 0 | 0 | 0 | 0 |
| Bid-offer : Delta | 5,558 | | 5,558 | | | | | | |
| Contingent Liability | 3,880 | | | 3,880 | | | | | |
| Deal Specific - To be re-categorised | 0 | | | | | | | | 0 |
| Bid-offer : Delta (GPS) | 1,247 | | 1,247 | | | | | | |
| Contingent Liability (GPS) | 1,323 | | | 1,323 | | | | | |
| Model : Fit (GPS) | (6,404) | (6,404) | | | | | | | |
| HIGH YIELD CREDIT | 4,914 | 0 | 4,346 | 0 | 0 | 0 | 0 | 0 | 568 |
| Bid-offer : Delta | 1,940 | | 1,940 | | | | | | |
| Deal Specific - To be re-categorised | 518 | | | | | | | | 518 |
| Bid-offer : Delta (FID Corp Loans) | 1,021 | | 1,021 | | | | | | |
| Bid-offer : Delta (High Yield EEMEA) | 1,385 | | 1,385 | | | | | | |
| Deal Specific - To be re-categorised (High Yield EEMEA) | 50 | | | | | | | | 50 |
| LIQUID MARKETS PROP | 583 | 0 | 583 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bid-offer : Delta | 583 | | 583 | | | | | | |
| FX | (5,186) | (16,066) | 3,763 | 0 | 0 | 0 | 0 | 136 | 6,981 |
| Bid-offer : Delta | 3,763 | | 3,763 | | | | | | |
| Contingent Deal | 0 | | | 0 | | | | | |
| Model : Skew | (16,066) | (16,066) | | | | | | | |
| Non-Contractual Early Termination Valuation Adjustment | 136 | | | | | | | 136 | |
| Deal Specific - To be re-categorised (FX EEMEA) | 6,981 | | | | | | | | 6,981 |
| SEURITIZED PRODUCTS | 18,348 | 0 | 0 | 18,348 | 0 | 0 | 0 | 0 | 0 |
| Parameter Uncertainty | 0 | | | | 0 | | | | |
| Liquidity : Concentration | 0 | | | | 0 | | | | |
| Contingent Liability | 18,348 | | | 18,348 | | | | | |
| FID Corporate | 16,912 | 528 | 11,173 | 0 | 0 | 0 | 0 | 5,211 | 0 |
| Bid-offer : Correlation | 0 | | 0 | | | | | | |
| Bid-offer : Vega | 11,173 | | 11,173 | | | | | | |
| Contractual Early Termination Valuation Adjustment | 5,211 | | | | | | | 5,211 | |
| Model : Approximation | 0 | 0 | | | | | | | |
| Model : Skew | 528 | 528 | | | | | | | |
| Parameter Uncertainty | 0 | | | | 0 | | | | |
| FID EUROPE TOTAL VALUATION ADJs | 780,717 | 214,151 | 189,685 | 89,999 | 134,646 | 0 | 0 | 109,188 | 43,048 |

VALUATION ADJUSTMENTS – Asia

| Asia - Valuation Adjs | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|--|---------------|---------------|--------------|------------------------|--------------|--------------|--------------|---------------|------------|
| FID DERIVATIVES | 58,688 | 40,986 | 8,252 | 0 | 1,700 | 7,750 | 0 | 0 | 0 |
| Bid/Offer | 8,252 | | 8,252 | | | | | | |
| Model Adjustment | 40,986 | 40,986 | | | | | | | |
| Liquidity Adjustment | 1,700 | | | | 1,700 | | | | |
| Credit Adjustment | 7,750 | | | | | 7,750 | | | |
| Early Termination Adjustment | 0 | | | | | | | 0 | |
| HIGH GRADE CREDIT | 5,333 | 940 | 2,781 | 0 | 400 | 413 | 854 | (55) | 0 |
| Documentation adjustments | 676 | | | | | | 676 | | |
| Basket Correlation Adjustment | 0 | 0 | | | | | | | |
| Bid/Offer | 2,781 | | 2,781 | | | | | | |
| Corr and Vol - CMDS | 940 | 940 | | | | | | | |
| Early Termination Adjustment | (55) | | | | | | | (55) | |
| Adjustment against claim for Enron | 413 | | | | | 413 | | | |
| Deal Specific | 178 | | | | | | 178 | | |
| CMCDS - Model | 0 | 0 | | | | | | | |
| VideoCon | 400 | | | | 400 | | | | |
| CDO | 275 | 0 | 54 | 0 | 0 | 0 | 95 | 0 | 126 |
| Belle Haven II PPN \$6.3m equity tranche | 126 | | | | | | | | 126 |
| Documentation adjustments | 95 | | | | | | 95 | | |
| Bid/Offer Adjustments | 54 | | 54 | | | | | | |
| FX | 26 | 0 | 26 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bid / Offer Adjustment | 26 | | 26 | | | | | | |
| HIGH YIELD | 6,888 | 0 | 2,663 | 0 | 0 | 0 | 4,225 | 0 | 0 |
| Expense Adjustments | 2,072 | | | | | | 2,072 | | |
| Bid/Offer Adjustment | 2,663 | | 2,663 | | | | | | |
| Deal Specific Adjustment | 2,153 | | | | | | 2,153 | | |

VALUATION ADJUSTMENTS – Asia

| Asia - Valuation Adjs | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|--|---------------|---------------|---------------|------------------------|--------------|--------------|--------------|---------------|------------|
| REAL ESTATE | 66 | 0 | 0 | 0 | 0 | 0 | 66 | 0 | 0 |
| Deal Specific Adjustment | 0 | | | | | | 0 | | |
| Expense Adjustment | 66 | | | | | | 66 | | |
| SECURITIZED PRODUCTS | 4,993 | 0 | 0 | 0 | 0 | 868 | 4,125 | 0 | 0 |
| Expense Adjustment | 3,358 | | | | | | 3,358 | | |
| Credit Adjustment | 868 | | | | | 868 | | | |
| Solid Loan Income Adjustment | 0 | | | | | | | | 0 |
| Adjustment for Receivable of GTFS's Buyer and Legal Expenses | 767 | | | | | | 767 | | |
| Commodities Trading | 1,045 | 0 | 1,045 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bid / Offer Adjustment | 1,045 | | 1,045 | | | | | | |
| FID CORP | 3,377 | 0 | 3,377 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bid / Offer | 41 | | 41 | | | | | | |
| PRDC - Model Adjustment | 0 | 0 | | | | | | | |
| Range-bounding Adjustment | 3,336 | | 3,336 | | | | | | |
| FID ASIA TOTAL VALUATION ADJs | 80,691 | 41,926 | 18,198 | 0 | 2,100 | 9,031 | 9,365 | (55) | 126 |

VALUATION ADJUSTMENTS – monthly changes

| Business | Total | Contingent | | | | | Risk | | Valuation |
|------------------------------|-----------------|----------------|-----------------|----------------|----------------|---------------|----------------|-----------------|--------------|
| | | Model | Bid/Offer | Liabilities | Liquidity | Credit | Expense | Transfer | |
| Liquid Market Prop | 191 | - | 191 | - | - | - | - | - | - |
| Interest Rate Products | (57,690) | (5,093) | (7,859) | - | 803 | (1,907) | - | (45,830) | 2,196 |
| Foreign Exchange | (1,614) | 1,470 | 461 | (2,405) | - | - | - | 562 | (1,702) |
| High Grade Credit | (16,286) | (13,179) | (2,237) | (7) | (863) | - | - | (55) | 55 |
| CDO | (9,905) | 9,235 | 731 | 6,033 | 4,215 | (5,454) | (486) | (24,177) | (2) |
| High Yield | (301) | (1,000) | 1,546 | - | - | - | (847) | - | - |
| Real Estate | 8,714 | - | - | - | - | - | 3 | - | 8,711 |
| Munis | 3,811 | - | (1,121) | - | - | 3,405 | - | 1,565 | (38) |
| Securitized Products | 36,344 | - | (8,918) | (5,222) | - | 55,174 | (3,996) | - | (694) |
| Commodities Trading | 1,126 | 280 | 568 | - | (22) | 400 | - | - | (100) |
| FID Corporate | (5,160) | - | - | - | (5,160) | - | - | - | - |
| Total FID Adjustments | (40,770) | (8,287) | (16,638) | (1,601) | (1,027) | 51,618 | (5,326) | (67,935) | 8,426 |

VALUATION ADJUSTMENTS – monthly changes

| | Total | Model | Bid/Offer | Contingent Liabilities | Liquidity | Credit | Expense | Risk Transfer | Valuation |
|------------------------|-----------------|-----------------|-----------------|------------------------|----------------|----------------|----------------|-----------------|--------------|
| America | | | | | | | | | |
| Liquid Markets Prop | 191 | - | 191 | - | - | - | - | - | - |
| Interest Rate Products | (2,940) | 3,006 | (1,961) | - | (2,056) | (1,929) | - | - | - |
| Foreign Exchange | 254 | 128 | 1,253 | - | - | - | - | 575 | (1,702) |
| High Grade Credit | (2,697) | - | (1,834) | - | (863) | - | - | - | - |
| CDO | 1,544 | 1,978 | 52 | - | - | - | (486) | - | - |
| High Yield Credit | 792 | (1,000) | 1,792 | - | - | - | - | - | - |
| Real Estate | 8,711 | - | - | - | - | - | - | - | 8,711 |
| Munis | 3,811 | - | (1,121) | - | - | 3,405 | - | 1,565 | (38) |
| Securitized Products | 38,096 | - | (8,918) | (4,610) | - | 54,982 | (2,664) | - | (694) |
| Commodities Trading | 300 | - | - | - | - | 400 | - | - | (100) |
| FID Corporate | - | - | - | - | - | - | - | - | - |
| Total America | 48,062 | 4,112 | (10,546) | (4,610) | (2,919) | 56,858 | (3,150) | 2,140 | 6,177 |
| Europe | | | | | | | | | |
| Capital Mkts Fund JV | (59,172) | (8,262) | (4,272) | - | - | - | - | (46,638) | - |
| Liquid Markets Prop | - | - | - | - | - | - | - | - | - |
| Interest Rate Products | 2,914 | (534) | (715) | - | 1,159 | - | - | 808 | 2,196 |
| Foreign Exchange | (1,827) | 1,342 | (751) | (2,405) | - | - | - | (13) | - |
| Commodities Trading | 362 | 280 | 104 | - | (22) | - | - | - | - |
| High Grade Credit | (13,267) | (13,179) | (81) | (7) | - | - | - | - | - |
| High Yield Credit | (629) | - | (629) | - | - | - | - | - | - |
| CDO | (11,449) | 7,257 | 679 | 6,033 | 4,215 | (5,454) | - | (24,177) | (2) |
| Securitized Products | (612) | - | - | (612) | - | - | - | - | - |
| FID Corporate | (5,160) | - | - | - | (5,160) | - | - | - | - |
| Total Europe | (88,840) | (13,096) | (5,665) | 3,009 | 192 | (5,454) | - | (70,020) | 2,194 |
| Asia | | | | | | | | | |
| Interest Rate Products | 1,508 | 697 | (911) | - | 1,700 | 22 | - | - | - |
| High Grade Credit | (322) | - | (322) | - | - | - | - | (55) | 55 |
| CDO | - | - | - | - | - | - | - | - | - |
| Foreign Exchange | (41) | - | (41) | - | - | - | - | - | - |
| High Yield Credit | (464) | - | 383 | - | - | - | (847) | - | - |
| Real Estate | 3 | - | - | - | - | - | 3 | - | - |
| Securitized Products | (1,140) | - | - | - | - | 192 | (1,332) | - | - |
| Commodities Trading | 464 | - | 464 | - | - | - | - | - | - |
| FID Corporate | - | - | - | - | - | - | - | - | - |
| Total Asia | 8 | 697 | (427) | - | 1,700 | 214 | (2,176) | (55) | 55 |
| Global Total | (40,770) | (8,287) | (16,638) | (1,601) | (1,027) | 51,618 | (5,326) | (67,935) | 8,426 |

LEHMAN BROTHERS

LEHMAN BROTHERS

PRICING REPORT – explanation of significant variances

| Business | Exposure Type | Level | Risk Measure | Exposure Size \$'000 | Initial Variance \$'000 | Remarkd \$'000 | Resolved \$'000 | Resolution |
|-----------------|--------------------------------|-------|--------------|----------------------|-------------------------|----------------|-----------------|--|
| Americas | | | | | | | | |
| Bank Loans | FORD MOTOR COMPANY (12/15/06) | 2 | MV | 671,250 | (4,553) | (4,553) | | Variance is due to size of concentrated position. Actual variance is 0.7%. Remarkd from \$89.5 to \$88.5 for (\$7.5mm). |
| Bank Loans | CAPMARK FINANCIAL GROUP INC. | 2 | MV | 45,000 | (4,110) | (4,110) | | Remarkd from \$90 to \$84 for (\$3mm). |
| Bank Loans | CIT GROUP INC. 5-YR (04/13/05) | 2 | MV | 52,663 | (2,898) | (2,898) | | Remarkd from \$95.75 to \$95 for (\$0.4mm). |
| Bank Loans | DISCOVER FINANCIAL SERVICES 07 | 2 | MV | 53,625 | (2,720) | (2,720) | | Remarkd from \$97.50 to \$96 for (\$0.8mm). |
| Bank Loans | CIT GROUP INC. 5 YR (4/14/04)/ | 2 | MV | 63,375 | (2,172) | (2,172) | | Remarkd from \$97.5 to \$96 for (\$1mm). |
| Bank Loans | CIT GROUP INC 5 YEAR (10-03)/5 | 2 | MV | 90,881 | (1,948) | (1,948) | | Remarkd from \$98.25 to \$98 for (\$0.2mm) |
| Bank Loans | PECOS INVESTORS LLC (1ST LIEN) | 2 | MV | 147,750 | 1,688 | | 1,688 | Variance is due to size of concentrated position. Actual variance is 1.1% |
| Bank Loans | AT&T INC. (7/12/06)/5-YR REVOL | 2 | MV | 532,593 | (1,494) | (1,494) | | Variance is due to size of concentrated position. Actual variance is 0.3%. Remarkd from \$99.55 to \$99.40 for (\$0.8mm). |
| Bank Loans | SOUTHERN CALI EDISON A&R(2-23- | 2 | MV | 204,445 | (1,417) | (1,417) | | Variance is due to size of concentrated position. Actual variance is 0.7%. Remarkd from \$99.13 to \$98.875; reduce variance to \$0.9mm aggressive. |
| Bank Loans | METAVANTE CORP. (PROJECT MONTA | 2 | MV | 86,400 | 1,125 | | 1,125 | Variance is due to size of concentrated position. Actual variance is 1.3% |
| Bank Loans | EQUITABLE RESOURCES INC 5YR RC | 2 | MV | 93,338 | 1,117 | | 1,117 | Variance is due to size of concentrated position. Actual variance is 1.2% |
| Bank Loans | AMGEN INC. (11/02/07)/5-YR REV | 2 | MV | 175,503 | (1,048) | (1,048) | | Variance is due to size of concentrated position. Actual variance is 0.6%. Remark from \$98.88 to \$98.625 for (\$0.4mm). |
| Bank Loans | ENTERGY CORP 3.5BN 5-YR RC | 2 | MV | 93,100 | 1,008 | | 1,008 | Variance is due to size of concentrated position. Actual variance is 1.1% |
| Bank Loans | CVS CORPORATION 5YR 05-12-06/5 | 2 | MV | 106,358 | (1,006) | | (1,006) | Variance is due to size of concentrated position. Actual variance is 1.0% |
| Bank Loans | EL PASO A&R 07-31-06/REVOLVER | 2 | MV | 48,000 | 1,000 | | 1,000 | Variance is due to size of concentrated position. Actual variance is 2.1% |
| Bank Loans | CCR CDS | 2 | PV01 | 18 | (1,028) | | (1,028) | 5yr Countrywide CDS was trading around 1100 bps per annum. Countrywide credit spread was very volatile prior to Bank of America's acquisition announcement in early January. Countrywide was trading at running spread and switched to upfront spread towards the end of December. Although variance is 57 bps, Lehman was still within Market consensus range. Variance may be due to the following: 1) different recovery rate assumptions, 2) different assumptions in converting upfront spread to running spread and 3) volatile market with wide bid / offer spread. |
| Cash CDO | CRONA 2007-1A A1A CORONA BOREA | 3 | MV | 517,500 | (39,900) | | (39,900) | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | CEAGO 2007-1A A1 CEAGO ABD CDO | 3 | MV | 620,500 | 9,350 | | 9,350 | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | CEAGO 2007-1A B CEAGO ABD CDO | 3 | MV | 10,080 | 1,008 | | 1,008 | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | CEAGO 2007-1A S CEAGO ABD CDO | 3 | MV | 5,729 | (2,444) | | (2,444) | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | CEAGO 2007-1A C CEAGO ABD CDO | 3 | MV | 5,060 | 956 | | 956 | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | PYXIS 2007-1A B PYXIS ABS CDO | 3 | MV | 5,600 | 1,392 | | 1,392 | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | PYXIS 2007-1A C PYXIS ABS CDO | 3 | MV | 2,350 | 570 | | 570 | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | BALLYROCK ABS CDO LTD FRN 2047 | 3 | MV | 12,375 | (1,063) | | (1,063) | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |

PRICING REPORT – explanation of significant variances

| Business | Exposure Type | Level | Risk Measure | Exposure Size \$'000 | Initial Variance \$'000 | Marked \$'000 | Resolved \$'000 | Resolution |
|-----------------------------|---------------------------------|-------|--------------|----------------------|-------------------------|---------------|-----------------|--|
| Cash CDO | BALLYROCK ABS CDO LTD FRN 2047 | 3 | MV | 10,548 | (926) | | (926) | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| Cash CDO | BLHV 05-1A COM1REGS BELLE HAVE | 3 | MV | 16,710 | (4,030) | | (4,030) | Desk is in the process of re-marking their positions on ABS CDO's and will provide support for their marks to PCG shortly. |
| High Grade Credit: Americas | CAM US FINANCE SA SOCIEDAD UNI | 2 | MV | 91,939 | 949 | | 949 | Variance is due to size of position held. Actual variance is 1.0%. |
| High Grade Credit: Americas | CME GROUP INC./REVOLVER EURO + | 2 | MV | 387,500 | (697) | | (697) | Variance is due to size of position held. Actual variance is 0.2%. |
| High Grade Credit: Americas | SCOTIA PACIFIC CO LLC | 2 | MV | 24,045 | (579) | | (579) | Retested in Jan and variance was under threshold. |
| High Grade Credit: Americas | GMAC | 2 | PV01 | 360 | 961 | | 961 | Variance is due to size of position held. Actual variance is 2.7 bps. |
| High Grade Credit: Americas | BSC | 2 | PV01 | 388 | 982 | | 982 | Retested in Jan and variance was under threshold. |
| High Grade Credit: Americas | MER | 2 | PV01 | 414 | 859 | | 859 | Illiquid at long end of the curve; Leh curve shape seems reasonable compared with Market. Actual variance is 2.1 bps. |
| High Grade Credit: Americas | CAPMRK | 2 | PV01 | 13 | 766 | | 766 | Retested in Jan; variance was reduced but still above threshold. PCG will discuss with desk. |
| High Grade Credit: Americas | PXD | 2 | PV01 | 110 | (753) | (753) | | Stale curve; trader has updated marks. |
| High Grade Credit: Americas | MUR | 2 | PV01 | 46 | (670) | (670) | | Stale curve; trader has updated marks. |
| High Grade Credit: Americas | CDX_IG_0610 | 2 | PV01 | 659 | 575 | | 575 | Variance is due to size of position held. Actual variance is 0.9 bps. |
| High Grade Credit: Americas | MBI | 2 | PV01 | 81 | 563 | | 563 | MBIA is a monoline insurer. Sector has been very volatile, especially at short end. Spreads are trading at very wide levels due to market placing a high probability that the name will default in the near future. Desk marked 5Y point consistent with trading activities. Actual variance is 6.9 bps. |
| High Grade Credit: Americas | IACI | 2 | PV01 | 394 | (557) | | (557) | Retested in Jan and variance was under threshold. |
| High Grade Credit: Americas | CDX_IG_0612 | 2 | PV01 | 1,619 | 538 | | 538 | Variance is due to size of position held. Actual variance is 0.3 bps. |
| High Yield Bonds | HD SUPPLY INC SR NT 144A R/MD | 2 | MV | 777,833 | 4,167 | | 4,167 | Independent spread (above 3-month LIBOR) is benchmarked from 11/30/07 B/CCC+ Consumer- cyclical USD average 3-5 yr index. Highly distressed name in a distressed sector. Actual variance is 0.5%. |
| High Yield Bonds | HD SUPPLY INC SR SUB PIK NT | 2 | MV | 366,426 | (2,297) | | (2,297) | Independent spread (above 3-month LIBOR) is benchmarked from 11/30/07 CCC+ Consumer- cyclical USD average 3-5 yr index. Highly distressed name in a distressed sector. Actual variance is 0.6%. |
| High Yield Bonds | CDW \$940MM SR. SUB BRIDGE | 2 | MV | 244,099 | (1,545) | | (1,545) | Variance is due to size of position held. Actual variance is 0.6%. |
| High Yield Bonds | CDW \$1.040BN SR.BRIDGE | 2 | MV | 142,615 | 923 | | 923 | Variance is due to size of position held. Actual variance is 0.7%. |
| High Yield Bonds | VERTRUE INCORPORATED 2ND LIEN | 2 | MV | 94,392 | (918) | | (918) | Variance is due to size of position held. Actual variance is 1.0%. |
| High Yield Bonds | FIRST DATA SR.SUB.BRIDGE (9/24) | 2 | MV | 285,643 | (861) | | (861) | Variance is due to size of position held. Actual variance is 0.3%. |
| High Yield Bonds | HYP MEDIA HOLDINGS LLC | 2 | MV | 127,400 | (849) | | (849) | Variance is due to size of position held. Actual variance is 0.7%. |
| High Yield Bonds | ONCOR (TXU) ELT DEL CO | 2 | MV | 170,156 | (785) | | (785) | Variance is due to size of position held. Actual variance is 0.5%. |
| High Yield Bonds | FIRST DATA BRIDGE | 2 | MV | 187,395 | (756) | | (756) | Variance is due to size of position held. Actual variance is 0.4%. |
| High Yield Bonds | PQ CORPORATION 2ND LIEN | 2 | MV | 140,300 | (715) | | (715) | Variance is due to size of position held. Actual variance is 0.5%. |

PRICING REPORT – explanation of significant variances

| Business | Exposure Type | Level | Risk Measure | Exposure Size \$'000 | Initial Variance \$'000 | Remarkd \$'000 | Resolved \$'000 | Resolution |
|----------------------|-----------------------------------|-------|--------------|----------------------|-------------------------|----------------|-----------------|---|
| High Yield Bonds | CDX_HY_100_S8_0610 | 2 | PV01 | 1,100 | (9,215) | | (9,215) | Retested in Jan, variance was less than 3bps |
| High Yield Bonds | CDX_HY_100_S8_0612 | 2 | PV01 | 806 | 4,375 | | 4,375 | Retested in Jan, variance was less than 3bps |
| High Yield Bonds | CDX_HY_100_S8_0614 | 2 | PV01 | 871 | (3,637) | | (3,637) | Retested in Jan, variance was less than less than 3bps |
| High Yield Bonds | SIX | 2 | PV01 | 71 | (3,060) | | (3,060) | Retested in Jan, trading upft, Leh5Y substantiated with trade activity |
| High Yield Bonds | CDX_HY_100_S9_1212 | 2 | PV01 | 2,095 | 2,935 | | 2,935 | Variance is due to size of position held. Actual variance is 1 bp. |
| High Yield Bonds | TRW | 2 | PV01 | 188 | 1,545 | | 1,545 | Retested in Jan; trades on 1/14 support Leh 5Y mark |
| High Yield Bonds | URI | 2 | PV01 | 104 | (1,329) | | (1,329) | Retested in Jan; Leh 5Ymark substantiated with trade activity |
| High Yield Bonds | RAD | 2 | PV01 | 153 | (1,231) | | (1,231) | Leh 5Y mark substantiated with trade activity around month end. |
| High Yield Bonds | HOV | 2 | PV01 | 81 | 1,199 | | 1,199 | Retested in Jan; trading in upfront points; Leh 5Y mark differs from trade activity by 2 upfront points; difference should be within bid/offer spread. |
| High Yield Bonds | UVN | 2 | PV01 | 261 | (1,192) | | (1,192) | High beta name, volatile market, 5Y Leh mark in Jan substantiated using trade activity |
| Emerging Market | Venezuela CDS | 2 | PV01 | 698 | (772) | | (772) | Leh marks were consistent with trading activities around month end |
| Emerging Market | Brazil CDS | 2 | PV01 | 2,230 | (603) | | (603) | Variance is due to size of position held. Actual variance is 0.3 bp. |
| Emerging Market | BM&F EXCHANGE SEATS SHR NPV BR | 1 | MV | 26,155 | 946 | 946 | | Position remarked on 1/11; new variance is within threshold |
| Securitized Products | Reconstituted Nims | 3 | MV | 69,864 | 4,672 | | 4,672 | Desk prices fall within PCG's stressed base case assumptions |
| Securitized Products | Residuals | 3 | MV | 1,075,304 | (22,272) | | (22,272) | Desk prices fall within PCG's stressed base case assumptions |
| Muni - Cash | City of Becker, Minnesota | 2 | MV | 60,001 | (1,480) | | (1,480) | There are 3 positions with notional of \$50mm for each. The desk marked all 3 positions at the same price. IDC has two positions priced the same and one different due to maturity difference. These bonds usually trade at similar levels, and thus, the market does not factor the maturity difference. As such, PCG agrees with the desk price. Actual variance is 2.5%. |
| Muni - Cash | City of Becker, Minnesota | 2 | MV | 60,001 | (649) | | (649) | There are 3 positions with notional of \$50mm for each. The desk marked all 3 positions at the same price. IDC has two positions priced the same and one different due to maturity difference. These bonds usually trade at similar levels, and thus, the market does not factor the maturity difference. As such, PCG agrees with the desk price. Actual variance is 1.1%. |
| Muni - Cash | City of Becker, Minnesota | 2 | MV | 60,001 | (649) | | (649) | There are 3 positions with notional of \$50mm for each. The desk marked all 3 positions at the same price. IDC has two positions priced the same and one different due to maturity difference. These bonds usually trade at similar levels, and thus, the market does not factor the maturity difference. As such, PCG agrees with the desk price. Actual variance is 1.1%. |
| Muni - Cash | GARDEN ST PRESERVATION TR NJ O | 2 | MV | 95,729 | (922) | | (922) | Desk is aggressively trading this position in January with \$30mm sold on 1/10 at 121.662. Trader's price as of date of testing (1/14) was 122.454 vs IDC mark of 121.405. External price is too conservative and variance is due to size of position held. Actual variance is 1.0% |
| Muni - Cash | Illinois Housing (AMT) | 2 | MV | 16,724 | (834) | | (834) | Bonds marked to a spread consistent with bids in late Dec. Trades in Dec on Cal St Vet Housing of \$30mm notional at price of 100, which is consistent with trader's mark. |
| Muni - Cash | City of Arlington, Texas | 2 | MV | 26,511 | (677) | | (677) | Marked to average life (less than 5 years) and IDC prices to 29-yr maturity. Average life calc is based on growth scenario that is evaluated periodically by desk. PCG agrees with desk valuation. |
| Muni - Cash | ALASKA HSG FIN CORP HOME MTG R | 2 | MV | 16,380 | (639) | | (639) | Rates rallying and pricing service not catching up with value of bonds in Dec. Desk sold \$25mm similar VA Housing at same yield as these (1/15) with similar structure and credit. |
| Muni - Cash | VIRGINIA ST HSG DEV AUTH (AMT) | 2 | MV | 43,312 | (568) | | (568) | Bonds marked to a spread consistent with bids in late Dec. Trades in Dec on Cal St Vet Housing of \$30mm notional at price of 100, which is consistent with trader's mark. |
| Muni - Cash | WASHINGTON ST HSG FIN COMMN (AMT) | 2 | MV | 22,140 | (556) | | (556) | Bonds are priced to average life and IDC is pricing to maturity, thus ignoring the quicker prepayment of this structure. PCG agrees with desk valuation. |

PRICING REPORT – explanation of significant variances

| Business | Exposure Type | Level | Risk Measure | Exposure Size \$'000 | Initial Variance \$'000 | Marked \$'000 | Resolved \$'000 | Resolution |
|--------------------|---|-------|--------------|----------------------|-------------------------|---------------|-----------------|--|
| Muni - Cash | Connecticut Single Family Housing (AMT) | 2 | MV | 35,745 | (555) | | (555) | Bonds are priced to average life and IDC is pricing to maturity, thus ignoring the quicker prepayment of this structure. PCG agrees with desk valuation. |
| Muni - Cash | COLO HSG FIN AUTH SINGLE (AMT) | 2 | MV | 12,113 | (545) | | (545) | Bonds are priced to average life and IDC is pricing to maturity, thus ignoring the quicker prepayment of this structure. PCG agrees with desk valuation. |
| Muni - Cash | COLO HSG FIN AUTH SINGLE (AMT) | 2 | MV | 12,113 | (545) | | (545) | Bonds are priced to average life and IDC is pricing to maturity, thus ignoring the quicker prepayment of this structure. PCG agrees with desk valuation. |
| Muni - Cash | CALIFORNIA HSG FIN AGY REV (AMT) | 2 | MV | 14,925 | (533) | | (533) | Bonds are priced to average life and IDC is pricing to maturity, thus ignoring the quicker prepayment of this structure. PCG agrees with desk valuation. |
| Muni - Cash | WISCONSIN HSG & ECONOMIC DEV A | 2 | MV | 23,085 | (521) | | (521) | Bonds marked to a spread consistent with bids in late Dec. Trades in Dec on Cal St Vet Housing of \$30mm notional at price of 100, which is consistent with trader's mark. |
| Muni - Cash | Johnson City - Mountain States | 2 | MV | 27,697 | 502 | | 502 | Bond was priced based on spread of 90 bps. The bond is also currently in a total return swap so there is no pnl impact resulting from a change in the bond price. The only impact a price change would have is on the amount of collateral the client has to post. |
| Muni - Cash | Harris County Health Facilities Dev. Corp. St Lukes | 2 | MV | 12,473 | 1,617 | | 1,617 | External pricing service prices these bonds to maturity. Front office marks to the par call date. Front office pricing methodology is consistent with "price-to-worst" convention practiced in the market. |
| Muni - Cash | SAN FRANCISCO CALIF CITY & CNT | 2 | MV | 64,239 | 2,582 | | 2,582 | MBIA insured bond - IDC not considering state of insurers. Priced conservative b/c of insurer. Prior trades in Dec were small odd lots ranging from 100.792 to 101.347. Spreads also widened in Dec and therefore PCG is comfortable with the desk's conservative mark. |
| Muni - Derivatives | PERALTA CALIF CMNTY COLLEGE | 2 | MV | 8,880 | 630 | | 630 | Peralta private placement and re-structuring bonds are not rated and not quoted by a broker. PC performs alternative valuation procedures by marking it to the level where taxable securities of similar credit are traded (libor + 100bps). PC discussed the variance with the desk and will continue to monitor this security going forward. |
| Real Estate | Boulder Springs | 3 | MV | 41,895 | 18,487 | | 18,487 | No markup suggested. Project is still in the entitlement process. As of 9/07, 9 of the 10 tentative tract maps have been approved. 3 have complete improvement plans and are ready to be submitted for approval. Developer has decided to upgrade the lots from paper lots to engineered lots which will increase cost and extend delivery time. |
| Real Estate | LB Kamalani | 3 | MV | 6,871 | 31,682 | | 31,682 | The property consists of a single parcel located off Waikoloa Beach Drive, on the island of Hawaii. Approximately, 51% of the project is unsold and 31% of construction is complete. Pricing variance primarily is from LB's \$21mm accumulated pref. No mark-up suggested at this time. |
| Real Estate | Bickman Ranch | 3 | MV | 23,050 | 13,852 | | 13,852 | No markup suggested. The project site consists of 1,947 acres of undeveloped land, located in West Placer County, CA. The site has been designated to become a master planned community with 1,887 residential home lots, retail shops, parks and a golf course. No lots have been sold in the entire project. Project still undergoing development. Pricing variance primarily originates from deferred interest. |
| Real Estate | Carillon South Tower | 3 | MV | 170,615 | 12,879 | | 12,879 | No markup suggested. The Project is a 582 condo, two Phase (South and North) development project in Miami Beach, FL. South tower received its final approval for TCO and units should begin closing shortly. Under-valuation originates from deferred fees and interest which is not recognized until payment is imminent. |
| Real Estate | EXHIBITION CITY JR MEZZ WHOLE | 3 | MV | 45,526 | 16,471 | | 16,471 | No mark-up suggested at this time. The property is a 55-acre parcel of land to be developed into a showroom facility in Las Vegas, Nevada. Additional financing was just extended to purchase and pre-develop two additional parcels adjacent to the current parcel. Overall financing package is being restructured. Priced in model at cap of 105%. |
| Real Estate | Miscellaneous | 2 | MV | N/A | (55,079) | | (55,079) | Other significant variances |
| Real Estate | Miscellaneous | 3 | MV | N/A | 15,101 | | 15,101 | Other significant variances |
| | | | | | (32,828) | (22,836) | (9,992) | |

PRICING REPORT – explanation of significant variances

| Business | Exposure Type | Level | Risk Measure | Exposure Size \$'000 | Initial Variance \$'000 | Remarkd \$'000 | Resolved \$'000 | Resolution |
|--------------------------------------|---|-------|--------------|----------------------|-------------------------|-----------------|-----------------|--|
| <i>Europe</i> | | | | | | | | |
| IRP Exotics | Inflation swap delta | 2 | PV01 | 628 | (2,511) | | (2,511) | Variance is attributable to curves for FRF and EUR indices. Variance is less than 1 bp at all points. |
| IRP Exotics | IR volatility | 2 | Vol + 1% | 9,872 | (4,321) | | (4,321) | Variance is attributable to volatility surfaces for GBP and EUR. Lehman's GBP volatility surface is outside of Totem's consensus range. PCG is having ongoing discussions with the desk. |
| High Yield | HY Loan Klockner Pentaplast | 2 | MV | 139,583 | (5,057) | (5,057) | | Position has been re-marked and variance has been reduced. |
| High Yield | First Chemical | 2 | MV | 50,798 | (1,599) | (1,599) | | Position has been re-marked and variance has been reduced. |
| High Yield | CWT | 2 | MV | 25,000 | (1,469) | (1,469) | | Position has been re-marked and variance has been reduced. |
| | | | | | (14,958) | (8,126) | (6,832) | |
| <i>Asia</i> | | | | | | | | |
| IRP - Derivatives | Interest rate swaps / FRAs / FX fwds - Interest rates | 2 | PV01 | 20,307 | (4,022) | | (4,022) | For JPY Libor, variance against Totem is (\$6.7mm) aggressive due to high marks on short term deposit rates. Desk marks are in line with the FRA (floating rate agreement) market. For JPY basis, variance against Totem is \$2.5mm conservative. Desk marks are on average 0.8 bp away from Totem. |
| High Grade Credit: Short term Credit | Convertible Bond - Noble Group LTD CONV BOND | 2 | MV | 29,500 | (750) | (750) | | Remarkd. |
| High Grade Credit: Short term Credit | CDO BESPOKE CORRELATION | 2 | N/A | N/A | (5,152) | (5,152) | | This is the total bespoke correlation variance for the Global CDO book of which 33% is allocated to Asia. UK is responsible for risk management and price testing. Variance is attributable to more volatile market conditions. Desk has re-marked and variance has been reduced. |
| | | | | | (9,924) | (5,902) | (4,022) | |
| Total Significant Variances | | | | | (57,710) | (36,864) | (20,846) | |

PRICING REPORT – coverage

| Exposures: | Risk Measure | Level 1 | | Level 2 | | Level 3 | |
|---|---------------|--------------|----------|------------|----------|---------|-----------|
| | | MV | Coverage | MV | Coverage | MV | Coverage |
| (I) Interest Rates | | | | | | | |
| Government Bonds & Bond Indexed Cash Products | MV | (19,776,935) | 100% | 532,454 | 84% | | |
| Listed Government Bond Options | MV | | | | | | |
| Money market & MM index cash products | MV | 45,445 | 100% | 6,110,355 | 100% | | |
| Listed Interest Rate Futures | MV | 10,872,572 | 100% | | | | |
| Listed Interest Rate Options | MV | (101,138) | 97% | | | | |
| Interest rates | PV01 | | | | 3,717 | 100% | 1,956 |
| Asset Swaps | PV01 | | | | | | |
| IR ATM volatility | Vol + 1% | | | | 26,999 | 99% | (979) |
| IR volatility skew: IR vol correlation | Vol + 1% | | | | 311 | 90% | |
| IR volatility skew: vol of vol | Vol + 1% | | | | (17,127) | 91% | |
| IR FX correlation | Correl + 1% | | | | | | 115 |
| IR IR correlation | Correl + 1% | | | | | | 78% |
| OTC Bond Option Price | MV | | | 7,036 | 100% | | |
| OTC Bond Option Volatility | Vol + 1% | | | | 4,260 | | (1,200) |
| Inflation Bonds | MV | | | | | | |
| Inflation Swaps & Options Delta | PV01 | | | | 628 | 98% | |
| Inflation Option Volatility | Vol + 1% | | | | | | |
| | | (8,960,056) | | 6,649,845 | | | |
| (II) Credit | | | | | | | |
| Corporate Bonds | MV | | | 11,230,604 | 86% | | 108,923 |
| Corporate Bond Options : Price | MV | | | | | | 97% |
| Corporate Bond Options : Volatility | Vol + 1% | | | | (1,275) | 100% | |
| Warrants | MV | | | 10,073 | 88% | | |
| Credit Spreads : Single Name | CS01 | | | | 851 | 85% | (902) |
| Credit Spreads : Bespoke | CS01 | | | | (6,703) | 96% | 74 |
| Index Spreads : Indices | IND01 | | | | (1,546) | 97% | |
| Index Spreads : Index Tranches | IND01 | | | | (972) | 100% | |
| Index Spreads : Bespoke | IND01 | | | | | | |
| Index Spreads Index Tranches | REF01 | | | | (134) | 99% | |
| Index Spreads Bespoke | REF01 | | | | 4,023 | 99% | |
| Tranche Spreads : Index Tranches | TR01 | | | | 39,984 | 97% | (44) |
| Tranche Spreads : Bespoke | TR01 | | | | (33,796) | 97% | |
| Bond collateral : CDO SPE transactions | MV | | | | | | |
| State Guaranteed Corporate Bonds | MV | | | | | | |
| Recovery rates | Recovery + 1% | | | | 2,360 | 88% | |
| Credit volatility | Vol + 1% | | | | 21 | 50% | |
| Third party CDOs | MV | | | 998,712 | 77% | | 1,514,685 |
| Bespoke Correlation | Correl + 10% | | | | (7,217) | 72% | |
| ABCDS | MV | | | 110,198 | 87% | | |
| | | | | 12,349,586 | | | 1,623,608 |
| (III) Equity | | | | | | | |
| Stock & Stock Index Cash Products | MV | 127,501 | 95% | 194,522 | 68% | | 1,200,060 |
| Stock & Stock Index Listed Futures | MV | 15,475 | 100% | | | | 72% |
| Stock & Stock Index Listed Options | MV | 41,423 | 83% | | | | |
| Stock & Stock Index Volatility | Vol + 1% | | | | 6 | 100% | |
| Equity correlation | Correl + 10% | | | | | | |
| Dividend rates | D Rho | | | | | | |
| Convertible Bonds | MV | | | 670,623 | 99% | | |
| Ascots | MV | | | | | | 7,715 |
| Equity swaps | Pos Delta | | | | | | |
| | | 184,399 | | 865,145 | | | 1,207,775 |
| (IV) Fund | | | | | | | |
| Fund units | MV | | | 1,244,808 | 100% | | |
| Fund volatility | Vol + 1% | | | | | | (6,122) |
| Fund vol of vol | Vol + 1% | | | | | | (472) |
| IR Fund NAV correlation | Correl + 20% | | | | | | (4,954) |
| Fund vol NAV correlation | Correl + 20% | | | | | | 279 |
| | | | | 1,244,808 | | | 100% |

PRICING REPORT – coverage

| SI 000 | Risk Measure | Level 1 | | | | Level 2 | | | | Level 3 | | | |
|---|--------------|---------------------|----------|------------|----------|--------------------|----------|------------|----------|-------------------|----------|------------|----------|
| | | MV | Coverage | Risk Based | Coverage | MV | Coverage | Risk Based | Coverage | MV | Coverage | Risk Based | Coverage |
| Exposures: | | | | | | | | | | | | | |
| (v) Mortgage | | | | | | | | | | | | | |
| Agency CMO / bond | MV | 102,333 | 100% | | | 15,189,789 | 100% | | | | | | |
| MBS bonds | MV | | | | | 8,302,188 | 100% | | | | | | |
| Pass-throughs | MV | | | | | 3,844,455 | 100% | | | | | | |
| Residuals | MV | | | | | | | | | 1,511,772 | 77% | | |
| Servicing rights | MV | | | | | 1,084,010 | 100% | | | | | | |
| Whole loans residential | MV | | | | | 13,801,792 | 91% | | | 1,468,553 | 84% | | |
| Mortgage volatility | MV | | | | | 664,306 | 63% | | | | | | |
| | | 102,333 | | | | 42,886,539 | | | | 2,980,325 | | | |
| (vi) Real Estate | | | | | | | | | | | | | |
| Whole loans commercial | MV | | | | | 20,775,386 | 100% | | | 3,629,603 | 100% | | |
| CMBS | MV | | | | | 10,144,926 | 100% | | | 218,423 | 100% | | |
| Property Derivatives | MV | | | | | | | | | | | | |
| | | | | | | 30,920,312 | | | | 3,848,025 | | | |
| (vii) FX Options | | | | | | | | | | | | | |
| FX Delta | MV | (12,424,222) | 100% | | | (259) | 96% | | | | | | |
| FX volatility | Vol + 1% | | | | | | | 7,820 | 99% | | | | |
| FX Vol skew | Vol + 1% | | | | | | | 3,180 | 98% | | | | |
| FX / FX correlation | Corr + 10% | | | | | | | | | | | | |
| | | (12,424,222) | | | | (259) | | | | | | | |
| (viii) Hybrid & Other | | | | | | | | | | | | | |
| ABS bonds | MV | | | | | 14,415,386 | 98% | | | | | | |
| Loans | MV | | | | | 52,318,291 | 90% | | | 3,231,771 | 79% | | |
| Principal transactions* | MV | | | | | | | | | 10,234,926 | 98% | | |
| Preferreds | MV | | | | | 8,929,285 | 18% | | | | | | |
| Airtax swaps | PV01 | | | | | | | | | | | (2,222) | 100% |
| Muni bonds | MV | | | | | 6,749,663 | 95% | | | | | | |
| | | | | | | 82,412,825 | | | | 13,466,697 | | | |
| (ix) Commodities | | | | | | | | | | | | | |
| Base Metals - Listed Futures & Options | MV | | | | | | | | | | | | |
| Base Metals - OTC Delta | PV01 | | | | 24 | 100% | | 385 | 84% | | | (34) | 98% |
| Base Metals - OTC Volatility | Vol + 1% | | | | | | | 631 | 97% | | | (938) | 100% |
| Crude Oil - Listed Futures & Options | MV | | | | | | | | | | | | |
| Crude Oil - OTC Delta | PV01 | | | | (1,373) | 100% | | 7,132 | 100% | | | | |
| Crude Oil - OTC Volatility | Vol + 1% | | | | | | | 489 | 99% | | | | |
| Emissions - Listed Futures & Options | MV | | | | | | | | | | | | |
| Emissions - OTC Delta | PV01 | | | | 794 | 100% | | (770) | 81% | | | | |
| Emissions - OTC Volatility | Vol + 1% | | | | | | | | | | | | |
| Natural Gas - Listed Futures & Options | MV | | | | | | | | | | | | |
| Natural Gas - OTC Delta | PV01 | | | | 3,045 | 100% | | (54,553) | 99% | | | (3,772) | 100% |
| Natural Gas - OTC Volatility | Vol + 1% | | | | | | | 1,766 | 99% | | | | |
| Power - Listed Futures & Options | MV | | | | | | | | | | | | |
| Power - OTC Delta | PV01 | | | | 110 | 88% | | 4,831 | 99% | | | | |
| Power - OTC Volatility | Vol + 1% | | | | | | | 576 | 63% | | | | |
| Precious Metals - Listed Futures & Options | MV | | | | | | | | | | | | |
| Precious Metals - OTC Delta | PV01 | | | | 394 | 100% | | 73 | 100% | | | (29) | 100% |
| Precious Metals - OTC Volatility | Vol + 1% | | | | | | | | | | | | |
| Refined Products - Listed Futures & Options | MV | | | | | | | | | | | | |
| Refined Products - OTC Delta | PV01 | | | | | | | | | | | | |
| Refined Products - OTC Volatility | Vol + 1% | | | | | | | | | | | | |
| Softs - Listed Futures & Options | MV | | | | | | | | | | | | |
| Softs - OTC Delta | PV01 | | | | 91,893 | 100% | | 10,991 | 90% | | | (47,907) | 67% |
| Softs - OTC Volatility | Vol + 1% | | | | | | | 114 | 99% | | | (174) | 79% |
| Commodity Indices - Delta | PV01 | | | | | | | 3,551 | 83% | | | (12,412) | 100% |
| Commodity Indices - Volatility | Vol + 1% | | | | | | | (548) | 55% | | | (1,977) | 76% |
| Commodity Correlation | MV | | | | | | | | | (80,806) | 31% | | |
| | | | | | | | | | | (80,806) | | | |
| Overall Totals | | (21,097,547) | | | | 177,328,801 | | | | 23,045,625 | | | |

* Principal Transactions exposure excludes \$4.6 billion of consolidated PTG positions from Real Estate Americas that are subject to Lower of Cost or Market.

PRICING REPORT – projects

| Business Line | Products | Contact Person | Region | Raising Issue | Issue | Risk of Misstatement (H/M/L) | Proposed Solution | System Enhancement Required (Y/N) | Due Date | Comment | Mitigating Controls (if any) |
|--------------------|------------------------|----------------|--------|---------------|---|------------------------------|--|-----------------------------------|----------|---|------------------------------|
| IRP | Caps | Alice Zhang | NY | | Need to assess cap vols skew p/l impact | H | Currently using Markit, however we are not calculating/reporting any p/l impact of using independent volatilities. | Y | 1Q08 | Working with IT to perform full re-pricing of the entire portfolio | |
| IRP | Caps and Swaptions | Alice Zhang | NY | | For cap and swaption volatility skew testing, need to switch to new model that the desk recently implemented. | H | Working with Quant Research and desk to revise calibration for new model. | N | 1Q08 | | |
| IRP | Exotics | Alice Zhang | NY | | Deal review processes are not in place for exotics | M | Establish deal review processes for exotics | N | 1Q08 | | |
| IRP | Exotics | Alice Zhang | NY | | Need to expand both IRP and FX exotics submission and price testing | M | Expand Totem usage. | N | 1Q08 | | |
| IRP | Options | Alice Zhang | NY | | Need to develop better methodology for the price testing of Bermudan and American options | M | Need to utilize Totem to test Bermudan options | Y | 1Q08 | Submitted to Totem the pricing of Bermudan options. Working on price testing methodology. | |
| IRP | General | Alice Zhang | NY | | Need to expand overall price testing coverage | M | Expand broker coverage | N | 1Q08 | Expanding broker coverage will be a continual process | |
| IRP | General | Alice Zhang | NY | | Need to improve the monitoring of variances | M | Implement variance time series tracking | N | 1Q08 | | |
| FX | Options | Alice Zhang | NY | | Skew testing for FX trades that are greater than 2 years - testing 57 pairs right now | M | Need automation on manual testing. | Y | 1Q08 | Need IT improvements & increase number of currency pairs tested. | |
| FX | Baskets | Alice Zhang | NY | | Need to expand all correlation parameters (including currency pairs) | M | Need to utilize Totem to test correlation inputs | N | 1Q08 | Already established price testing on 50% of currency pairs; continue to expand coverage. | |
| Energy | Eagle | Yong Huang | NY | | Eagle price testing starts late in the month due to lack of resource for coverage | M | Will visit Houston to get to know key stake holders. NY team has conducted several PT on the portfolio, made new progress each time but still not complete due to lack of resources. As India team is trained up, certain LB price testing will be shifted in a controlled fashion to direct more and more NY resources to develop price testing on Eagle's portfolio. | Y | | Currently price and position are sent by Eagle via email spreadsheet, hard to interpret. Once PC complete the position integration into Kinetix, will include Eagle in the normal process. In the interim, will work to get better position information out of Eagle's portfolio. | |
| Energy | Exotics | Yong Huang | NY | | Heat rate and other structure transaction testing: no third party quotes available currently | M | Continue working with Totem and 10x, develop and implement methodology to soft test heat rate deals, sensitivity analysis, monthly reconciliation b/t model and actual performance, historical correlation analysis, etc. | N | | | |
| Energy | Basket | Yong Huang | London | | Basket correlation testing: UK currently does not have a robust methodology | M | NY will work with UK to understand the Totem process, desk process and develop methodology and potentially take over the testing to NY | N | | | |
| Energy | General | Yong Huang | NY | | Asia price testing is currently handled by product control in Singapore, no dedicated local resource responsible | M | NY valuation control will take over entire Asia price testing from product control in Singapore | N | | | |
| Energy | General | Yong Huang | NY | | Price shape tracking: Price shape needs to be monitored | M | Develop and maintain tracking mechanism | N | | | |
| Energy | General | Yong Huang | NY | | Skew surface tracking: Skew surface needs to be monitored | M | Develop and maintain tracking mechanism | N | | | |
| Energy | General | Yong Huang | NY | | Structured portfolio is price tested with greeks as given, alternative procedure can be set up to test the the sensitivity of inputs on greeks output | M | Develop and implement methodology in NY once more routine price testing gets transferred to India | N | | | |
| Energy | General | Yong Huang | NY | | Key risk locations are not tested with ideal frequency due to resource constraint | M | Educate India team to carry out ad hoc price verification on key risk locations | N | | | |
| Energy | General | Yong Huang | NY | | 10x data is not used sufficiently in price testing due to lack of resource before | M | Resource constrain in NY prevent us from fully utilize 10x data. As India team get trained up, will utilize more on 10x return | N | | | |
| Energy | General | Yong Huang | NY | | Currently not involved in NPC items in UK | M | Coordinate with UK to get on European NPC agenda. | N | | | |
| Mortgages | Non-Economic Residuals | Joe Sapia | NY | | Not price tested. | L | Develop methodology | N | TBD | Exposure is immaterial with reserves being held out in Prime desk. | |
| Structured Finance | PFG Conduits | Joe Sapia | NY | | Not price tested | H | Develop methodology | N | TBD | Off-balance sheet positions | |

PRICING REPORT – projects

| Business Line | Products | Contact Person | Region | Raising Issue | Issue | Risk of Misstatement (H/M/L) | Proposed Solution | System Enhancement Required (Y/N) | Due Date | Comment | Mitigating Controls (If any) |
|---------------|--------------------------------------|----------------|--------|---------------|---|------------------------------|---|-----------------------------------|-------------|--|---|
| Credit | CDO | Brian Sciacca | Global | | Global Deal Review backlog is 250 trades | H | 4 out of 5 staff hired in India. Training is ongoing. 2008 headcount under discussion | N | 1Q08 | | |
| Credit | CDS | Brian Sciacca | NY | | CDS price testing dbase creates artificial variances and is extremely inefficient to use | H | IT headcount approved and in place. Project plan yet to be completed and approved | Y | TBD | | |
| Credit | CDS on ABS | Brian Sciacca | NY | | CDS on ABS is not price tested | H | Should be tested by ABS Val team as they have a better knowledge base and expertise | N | TBD | | |
| Credit | Equities and ABS | Brian Sciacca | NY | | Products such as equities and ABS are tested by GCP Val team. | L | Identify products and discuss outsourcing with other teams | N | 1Q08 | | |
| Credit | General | Brian Sciacca | NY | | Global Valuation reporting to be created for Management review | M | Create reports and distribute to Desk heads | N | 1Q08 | | |
| Credit | General | Brian Sciacca | NY | | Price testing policy documents need to be unified across products and regions | L | One detailed PV policy should be written and approved by PC and the Desk. Should include thresholds, categorization of variances and data, escalation procedures, etc | N | 1Q08 | | |
| Credit | General | Brian Sciacca | NY | | Control to be put in place to monitor stale marks | L | Begin monitoring the CDS tool. Look into creating a bond tool which monitors spreads | Y | TBD | CDS Resolved. Reports sent out monthly. Bonds yet to be addressed | |
| Credit | General | Brian Sciacca | NY | | Inadequate control in place to enforce "one firm one mark" policy | L | | Y | TBD | | |
| Credit | General | Brian Sciacca | NY | | Valuation reports are completed after day 20 of the month. This limits exposure, relevance, and our ability to resolve issues. It also reduces time for value added projects. | H | Evaluate requirements, build a price testing database, stream line inefficiencies and redundancies, prioritize components of PV, train staff, and hire new staff | Y | TBD | | |
| Credit | General | Brian Sciacca | NY | | Ensure all valid and reliable pricing sources are utilized. | M | Research the quality of current and new data sources. Incorporate into testing and categorize. Build a database to compile data efficiently | Y | 1Q08 | | |
| Credit | General | Brian Sciacca | NY | | Incorporation of recent trade prices into price testing work is extremely cumbersome and performed on a best effort basis when variances are large | M | Automated source to capture and incorporate into the price picking methodology | Y | TBD | | |
| Credit | General | Brian Sciacca | NY | | Insufficient time spent on IIG ensh testing. Val risk has increased substantially over the last few months. (SIV's, Auction Rate Sec, prefers, etc) | M | New staff to be hired and trained | N | TBD | | |
| Real Estate | Derivatives (Duration Neutral Swaps) | Abe Kebede | NY | | Not price tested | L | Obtain Population and develop pricing methodology | Y | 1Q08 | Product control working with front office, middle office and technology teams on developing a model | Middle office currently maintaining spreadsheets to calculate prnts |
| Real Estate | PTG | Abe Kebede | NY | | No servicer data for assets that are not serviced by either Trimont or FCCP | L | Discuss with business to transfer servicing to Trimont | N | TBD | \$ size low (<\$100mn); risk of misstatement immaterial | |
| Real Estate | PTG | Abe Kebede | NY | | Valuation methodology with Servicer for development-type assets outdated. | M | Discussions started with Front Office Asset Management and Risk Management to implement changes | N | 4Q07 / 1Q08 | Current valuation methodology for land and development projects is based on cap * 105%, which was a conservative or prudent approach is an up-market. Given current market conditions, this approach may not be appropriate. | |
| Commodities | Exotic Commodity Trades | Rob Honeyball | London | | Exotics outside of Kinetics are not price tested | M | Integration of models into Kinetics via Flexdeal and model approval process. | Y | 1Q08 | | |
| Commodities | Commodity Options and Baskets | Rob Honeyball | London | | Do not have the ability to effectively price test correlation and volatility surfaces due to the number of curves. | M | Currently developing IT solution to automate the process of submitting curves to consensus survey. | Y | 2Q08 | | |
| Commodities | Commodity Options and Baskets | Rob Honeyball | London | | Untested inventories on: 1) illiquid or long-dated positions, 2) index atm volatilities and 3) agricultural atm volatilities | L | Currently, methodology is slowly being developed for each product. Need to add headcount to expedite the process. | N | 2Q08 | | |

PRICING REPORT – projects

| Business Line | Products | Contact Person | Region | Raising Issue | Risk of Misstatement (H/M/L) | Proposed Solution | System Enhancement Required (Y/N) | Due Date | Comment | Mitigating Controls (if any) |
|----------------------|--|-----------------------------|--------|--|------------------------------|---|-----------------------------------|---|---|--|
| Credit | NTD Baskets | Tony Ellis | London | NTD Correlation risk untested | M | Benchmarking to Totem consensus data | Y | 1Q08 | Totem Consensus data received but not used in price testing | Hold an uncertainty reserve against this risk |
| Credit | CDO Tranchelets | Tony Ellis | London | Tranchelet risk not fully tested | L | Analysis vs Totem consensus data | N | 1Q08 | Totem Consensus data received but not used in price testing | |
| Credit | PO Liquid Tranches | Tony Ellis | London | PO levels not fully tested | M | Participate in Proposed Totem service | N | 1Q08 | Current price testing done on a risk basis. Good as proxy but price basis preferable | Currently tested on risk basis |
| Credit | Credit Swaptions | Tony Ellis | London | Only make a basic submission to Totem / limited results | L | Staff Training and meetings with Totem to understand their pricing process | N | 1Q08 | | Basic price testing shows conservative variance, good coverage |
| Credit | Derivatives on CLOs/CDOs | Tony Ellis | London | Coverage/Methodology to be improved | M | | N | 1Q08 | | |
| Credit | Super Senior CDO Tranches | Tony Ellis | London | Super senior levels not fully tested | M | | | TBD | | |
| Credit | CLO/CDO Residuals | Tony Ellis | London | Coverage/Methodology to be improved | M | | | TBD | | |
| Credit | High Yield | Richard Holmes | London | Loan CDS not price tested | L | Need to follow up. | N | TBD | | |
| Securitized Products | Residuals | Richard Holmes | London | Residuals policy to be developed | L | In development | N | TBD | | |
| Securitized Products | Non Performing Loans | Richard Holmes | London | Income recognition policy to be developed. Limited price testing done. | | To send income recognition policy for review. | | TBD | This is written - can send for review | |
| Securitized Products | Structured Finance | Richard Holmes | London | Some structured trades booked at transaction price and cash accounted. | | Spread lock trades do not have available curves. Need to follow up. | | TBD | | |
| All | All | All | London | Proof of price testing population completeness and integrity needed in many areas | M | Developed standardized template which has now been put into production | N | 1Q08 | Completed for CTE, Vanilla Rates completed but not yet rolled out due to resource limitations in the line, other products TBD | |
| All | All | All | London | Ongoing (i.e. post model review) calibration controls to be developed (global project) | M | Develop methodology | Y | TBD | | |
| All | All | All | London | Need to assess significance of exposure where Markit offer service but we don't subscribe - e.g. CMA, inflation exposures | L | Research Lehman products as well as what Markit offers. CMS now subscribed to CDS and CDO, ABS in future, not yet subscribed on Markit. | N | TBD | | |
| All | All | All | London | Need to ensure that all significant factors relevant to valuation are identified and covered | M | Credit perceives no issues | N | N/A | | |
| All | All | All | London | Need to develop full repricing methodology | M | Credit : Develop methodology IRP: Rates repricing being built in Optmodel Commodities: Develop Policy | Y | Credit: TBD, Commodities and IRP Q2, 2007 | Credit: Not yet key priority in credit and Commodities: To be included in the revamp of the policies generally by end of 1Q08 | |
| All | All | All | London | Alternative procedures to justify acceptance of marks on untested exposures need to be more precise. | | | | TBD | Being assessed through VCO review of PT templates | |
| All | All | All | London | Model reserve assessment to be completed in many areas | M | Work in Progress | Y | TBD | | |
| All | All | All | London | FAS 157 level 1, 2 and 3 classification of asset types to be concluded and embedded in price testing templates (global project) | | Tagging process ongoing, correct assignment of exposures to levels in PT templates needs proper line manager review | | TBD | | |
| Credit | High Yield (CBs, Bonds, Private Equity, Warrants, Loans) | Sharad Kochhar/ Jose Galvan | Tokyo | Coverage/Methodology to be improved. Most of the positions are in emerging market and privately placed with no publicly available market information. It is difficult to find comparable benchmarks. | H | Since Q3, we have started to have formal detailed discussion with desk on all material positions. The discussion is around actual financial performance of the investee vis-a-vis expected performance, performance of credit indices, IPO plans (if any) and refinancing. We are interviewing for a Credit Valuation role and the new person would focus on the valuation of credit portfolio. | N | TBD | | |
| Credit | High Yield (CBs, Bonds, Private Equity, Warrants, Loans) | Sharad Kochhar/ Jose Galvan | Tokyo | Valuation reports are completed after day 20 of the month. This limits exposure, relevance, and our ability to resolve issues. | H | Evaluate requirements, stream line inefficiencies and redundancies, prioritize components of PV and hire new staff | | TBD | | |
| Credit | Distressed Assets/ NPLs | Sharad Kochhar/ Jose Galvan | Tokyo | Coverage/Methodology to be improved. | H | To have the new dedicated credit valuation resource to look at valuation of NPLs and other distressed assets. To do formal independent valuation analysis based on realised and expected cashflows. | | TBD | | |