

# LEHMAN BROTHERS

## ACCOUNTING POLICY MEMO

<b>TO:</b>	Files
<b>FROM:</b>	Margaret Sear/Brett Beldner
<b>DATE:</b>	April 11, 2008
<b>SUBJECT:</b>	Freedom CCS 2008-1, Ltd (Freedom CLO)
<b>BUSINESS:</b>	Corporate
<b>STATUS:</b>	Final

### 1. Overview

Lehman securitized certain loan assets through a newly created SPE in order to create securities that could be used to raise financing from the Federal Reserve.

### 2. Transaction

On March 20, 2008, Lehman created two entities, Freedom CCS 2008-1, LTD, as the Issuer, and Freedom CCS 2008-1, CORP., as the Co-Issuer, (the Issuer and the Co-Issuer are collectively referred to here as the "Freedom CLO" or the "CLO".) These two entities issued \$2.825bn of securities to purchase participations in 66 senior secured and unsecured loans, as well as pay certain expenses and create interest reserves. The loan participations were purchased from the following Lehman entities:

<u>Legal Entities</u>	<u>Notional Value</u>	<u>Fair Value</u>
LCPI	\$ 1,447,489,336	\$ 1,236,809,171
LBCB <sup>1</sup>	1,183,633,182	1,069,743,981
Bankhaus	309,303,088	208,947,572
LCPI UK	100,000,000	93,000,000
LBBK <sup>1</sup>	77,333,333	61,940,833
Cash payments for interest reserve, expense and unfunded loans	-	154,558,443
<b>Total</b>	<b>\$ 3,117,758,939</b>	<b>\$ 2,825,000,000</b>

1. LBCB and LBBK are the originating entities for the loans. They participated their loans to LBHI which then participated them to Freedom CLO.

The CLO raised the \$2.825bn of cash proceeds by simultaneously issuing two classes of securities, both with a stated maturity of 11/15/2016:

- \$2.26bn of Senior Notes rated at A/A2 (the "Freedom Senior Bond"), bought by LBI, and
- \$565mm of Subordinated Notes (not rated) (the "Freedom Junior Bond") bought by LCPI.

The cash proceeds were used to pay the selling entities for the loans. However, on a consolidated basis, Lehman is cash neutral.

LBI used the Freedom Senior Bond as collateral in an overnight repurchase agreement with the Federal Reserve (Fed) via the tri-party arrangement with JPMorgan Chase (as our repo custodian) and received \$2.13 billion cash on each of March 24, 25 and 26 (i.e., we repo'd the bonds overnight for 3 days in a row.)

### 3. Accounting Analysis

#### 3.1 LBHI Consolidated

Prior to entering into a repo with the Fed, all transactions occurred between consolidated LBHI subsidiaries and therefore there is no accounting impact for these transactions in LBHI's consolidated financial statements. That is, the loans are not removed from balance sheet nor are securities issued by the Freedom CLO booked as assets. However, as a legal matter, we have in fact "sold" the loans and received securities instead.

LBHI, on a consolidated basis, recognized the cash received from the Fed as a repo transaction:

Dr. Cash	\$2.13bn	
Cr. Repo Liability		\$2.13bn

#### 3.2 Legal Entity Stand-Alone Basis Accounting

##### Sellers - LCPI / LBCB / Bankhaus / LCPI UK / LBBK

Since a Lehman entity sold a participation in an asset which on a consolidated basis we still control, we fail paragraphs 9a, 9b and 9c of FAS 140 and the selling entities cannot derecognize the transferred loans from their balance sheet. As a result, they have entered into a secured borrowing and should make the following entry for the amount of the loan participated:

Dr. Cash	XX	
Cr. Other Secured Borrowing		XX

##### LBI as purchaser of the Freedom Senior Bonds

LBI purchased the Senior Bonds from an affiliated entity (the CLO) for cash and booked the following entry:

Dr. Inventory	\$2.26 bn	
Cr. Cash		\$2.26 bn

When LBI repo'd the securities to the Fed, the entry is:

Dr. Cash	\$2.13 bn	
Cr. Repo Liability		\$2.13 bn

##### LCPI as purchaser of the Freedom Junior Bonds

LCPI, as seller of loans, booked the following entry:

Dr. Cash	\$1.236 bn	
Cr. Other Secured Borrowings		\$1.236 bn

LCPI, as purchaser of the Junior Bonds, booked the following entry:

Dr. Inventory	\$0.565 bn	
Cr. Cash		\$0.565 bn

Because the CLO is a Variable Interest Entity and LCPI owns the residual interest in the entity, it is required to consolidate the CLO under FIN 46R and record the following entries:

Dr. Loan Participations	\$2.825 bn	
Cr. Senior Bond		\$2.26 bn
Cr. Junior Bond		\$0.565 bn

However, because LCPI is consolidating the CLO, the original entry to record the Other Secured Borrowings (above) is reversed:

Dr. Other Secured Borrowing	\$1.236 bn	
Cr. Loan Participations		\$1.236 bn

In addition, the \$0.565 bn Junior Bond long and short positions eliminate, resulting in a gross up for only the "third party" (other Lehman entities) loan participations.

The net effect of the transaction on LCPI's balance sheet is:

Dr. Cash	\$0.671 bn	
Dr. Loan Participations	\$1.589 bn	
Cr. Freedom Senior Bond		\$2.26 bn