Presentation to the Audit Committee

Valuation review – 2nd quarter 2008

July 2008

LEHMAN BROTHERS

Overview

Topics to be covered:

◆ An overview of our Product Control Function which includes our Valuation Control function

◆ The key functions performed by our Valuation and Control group including Price Testing and determination of fair value level hierarchy

◆ A review of Q2 write downs and what market events or transactions drove them

◆ A walk through of our Q2 independent valuation results including sales activity during the quarter for Residential and Commercial Mortgages as well as Leveraged Loans

Product Control Core Functions

Business Analysis	Business Control	Valuation Control
REPORT & ANALYZE	**REVIEW & CONTROL**	**VALIDATE & ANALYZE**
• Consolidated reporting and Analysis across Revenue, Capital measures, Client Revenue, Allocations and Net Economics. • Provides business commentary and themes on Daily, Weekly, Monthly, and Quarterly business performance. • Analyzes business lines utilizing various finance metrics (ROE, ROA, Sharpe Ratio, VAR/Revenue, etc.) • Capital Resources Management - Monitors efficient use of balance sheet and capital (vs. firm targets) and how to better employ capital resources. Aging and BS by Use analysis. • Partners with business control to provide analysis to make informed decisions around optimal capital usage • Partners with the business controllers on Midyear and Year end planning. • Partners with business controllers on forecasts and ad-hoc analysis	• Responsible for Revenue analytics including highlight commentary. • Ensures a reviewed and controlled process from trade booking through to GL. Partners with business to close control gaps. • Reviews adjustments and deferral balances posted by RTC into books and records, including the support for these adjustments that are maintained by RTC. • Reviews & ensures transactions are reflected in accordance with current policies. Consults with Accounting Policy Group and/or Valuation when necessary. • Partners with trading desks on reviewing financial results and opportunities for capital efficiencies. • Analyzes financial information for 10-Q/10-K reporting (quarter over quarter fluctuations, etc.) • Works with Internal/External Audit on queries around the books and records controls. Informs or delegates queries to other groups when necessary	• Ensures positions are valued appropriately in the books and records at month-end (price verification) • Understand inputs which affect the valuation of a transaction and whether there are proper controls in place to price test those inputs. • Understand the models that are being utilized to value these trades and if they are approved for that particular transaction. • Partners with the Model Validation Group • Set policy for valuation adjustments, partnering with Accounting Policy. • Partner with Risk Management and Accounting Policy on Complex Derivative Transaction Review process, monitor and follow up on exceptions • Ascribe Fair value levels to all assets and liabilities subject to the Fair value standard

Revenue Transaction Control

- Reconcile the firms various trade capture systems to the firms P&L reporting systems (Gquest/Pals)
- Post adjustments and maintain documentation and support for all position and valuation breaks
- Complete P&L on T+1 in the reporting systems on a trader, desk and business level
- Create and maintain trader level P&L reporting
- Post adjustments and close the firms books and records in accordance with accounting standards and firm policies
- Reconcile firm P&L with books and records and post unresolved differences to deferral accounts
- Ensure pre-trade data integrity (cost center creation, account openings, mappings, trader names and other account or trade attributes)
- Lehman Risk vs. Books and Records reconciliation, exception investigation and resolution. "Clean P&L" back testing exception investigation and resolution

Valuation and Control Group – Price verification

◆ The group typically consists of technical staff who are very familiar with the products they cover

◆ They are responsible for verifying prices for assets and liabilities, both on and off balance sheet

◆ Prices are verified through:

- Data providers e.g. bond prices from EJV, IDC – prices are provided for individual bonds
- Consensus pricing services e.g. MarkIt partners – this covers a large part of the pricing spectrum through getting consensus pricing from major market participants
- Extrapolation from similar instruments – this may be appropriate where data is not available for a particular bond, loan etc
- Recent trading activity – either at Lehman or in the wider market

◆ Any significant variances are then escalated to senior management for further consideration

◆ Model control process – the review of models, in conjunction with the Quantitative research and Model validation groups, ensures that the models are appropriately valuing the derivative transactions entered into by the firm.

◆ Complex Derivatives Transactions – review of large or unusual transactions in conjunction with the Accounting policy and Risk management groups. This ensures that the entirety of the risks are taken into account when valuing a transaction or series of transaction e.g. long dated volatility transactions

Valuation and Control Group - Functions

◆ The Valuation and Control group is responsible for assigning Fair value levels to the assets and liabilities and for completing the disclosure requirements.

◆ Fair value level for a particular asset is determined according to the following guidelines:

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

- Level 2 – Inputs other than quoted prices 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 (e.g. interest rate and yield curves, observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks and default rates).

- Level 3 – Level 3 inputs reflect the Firm's assumptions that market participants would use in pricing the asset or liability. The Firm develops Level 3 inputs based on the best information available in the circumstances, which may include indirect correlation to a market value, combinations of market values or the Firm's proprietary data. Level 3 inputs generally include information derived through extrapolation or interpolation of observable market data.

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Residential Mortgages

Residential Mortgages – Write downs and market events

◆ Gross write downs for residential mortgages for Q2 were $2.4 billion compared to $3 billion in Q1.

◆ Peloton
  – Peloton defaulted at the end of February which created pressure on Alt A securities prices across the capital structure. For example, AAA prices declined as much as 15 points and subordinated bond prices declined more then 20 points during Q1. This led to a mark down of $1.1 billion in Q1 on Alt A securities.
  – During Q2 we saw AAA prices stabilize but saw a substantial decline in subordinated securities which generated a gross write down of $800 mm across our subordinated bond portfolio.

◆ NPL bulk sale
  – We executed a large non performing loan transaction in the latter part of Q2 with a distressed buyer. This trade generated a loss of close to $400 mm dollars as we remarked our remaining position to this distressed sale level.

◆ IMD Fund Asset Swap
  – We took a loss of $170 mm related to swapping subprime securities out of our ABS enhanced LIBOR Fund.

◆ Credit performance and spread widening
  – We took losses of $750 mm across a series of assets that had poor credit performance and or spread widening, that is liquidity related, to our prime whole loan, ABS CDOs, 2nd lien whole loans, Europe and residuals.

Residential Mortgages US - Prime

(in $ millions)

	Q2 2008								
	Balance Sheet Positions			**Transactions**		**Price Testing Results**			
	Balance	MV	Mark	Sales MV	Avg Px	Third Party and Recent Trade Pricing	Modeled Pricing	Testing Coverage	Testing Variance
Prime Fixed - PL	542	486	89.67	67	94.19		100.00%	100.00%	15
Prime Hybrid - PL	1,317	1,185	89.98	397	94.34		100.00%	100.00%	(49)
NPL	215	106	49.30	364	49.30	100.00%		100.00%	0
Other*	299	278	93.27				100.00%	100.00%	(20)
Whole Loans		2,055		828				100.00%	(54)
AAA	4,988	3,904	78.27	7,278	76.60	80.70%	19.30%	100.00%	2
Sub	4,749	1,771	37.29	222	49.20	52.60%	47.40%	100.00%	(11)
Securities		5,675		7,500		73.10%	26.90%	100.00%	(8)
Residuals		831					100.00%	100.00%	(18)
Servicing Rights		1,638					96.00%	96.00%	43
Total		10,200							(38)

Whole Loans

The performing whole loan population was price tested using a combination of recent trade activity and the average marks of other dealers.
The non performing whole loan population was price tested using recent trade activity.

Securities

loss and prepayment assumptions are utilized in price testing. Spreads are determined utilizing published sources such as JP Morgan monthly report as well as spreads on ABX.

Residuals

Intex Desktop using collateral specific curves and vectors obtained from either Loan performance, Inc via Lehmanlive or, developed in collaboration with Lehman Research.
Performance on Option ARM Exposure is mixed, To date these positions have performed well, producing cash flows in excess of $50mm per month, however, credit performance has deteriorated recently and we expect some write downs in the 3rd quarter.

Servicing Rights

internal research model that uses prepayment speeds as well as actual cost of servicing to forecast the future cash flow stream of the MSR.

Residential Mortgages US – Non-Prime

(in $ millions)

| | Balance Sheet Positions | | | Transactions | | Price Testing Results | | | |
	Balance	**MV**	**Mark**	**Sales MV**	**Avg Px**	**Third Party and Recent Trade Pricing**	**Modeled Pricing**	**Testing Coverage**	**Testing Variance**
Subprime	325	167	51.80	64	49.30	100.00%		100.00%	17
2nd Lien	1,339	885	66.10				100.00%	100.00%	(58)
Whole Loans		1,052		64				100.00%	(41)
AAA	1,230	919	74.71	1,238	88.53	65.20%	34.80%	100.00%	12
Sub	1,979	735	37.14	956	38.50	48.00%	52.00%	100.00%	18
Securities		1,654		2,194		59.59%	40.41%	100.00%	31
Residuals		32					100.00%	100.00%	6
Servicing Rights		21							
Total		2,759							(4)

Q2 2008

Whole Loans	The performing whole loan population was price tested using a combination of recent trade activity and the average marks of other dealers. The non performing whole loan population was price tested using recent trade activity.
Securities	Third-party marks where available. Intex Desktop is utilized when no vendor mark is available. Deal specific loss and prepayment assumptions are utilized in price testing. Spreads are determined utilizing published sources such as JP Morgan monthly report as well as spreads on ABX.
Residuals	Intex Desktop using collateral specific curves and vectors obtained from either Loan performance, Inc via Lehmanlive or, developed in collaboration with Lehman Research.

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Residential Mortgages US – Other

(in $ millions)

| | Balance Sheet Positions | | | Transactions | | Price Testing Results | | | |
| | | | | | | Q2 2008 | | | |
	Balance	MV	Mark	Sales MV	Avg Px	Third Party and Recent Trade Pricing	Modeled Pricing	Testing Coverage	Testing Variance
Scratch & Dent	889	386	43.40	95	49.30		100.00%	100.00%	51
Reverse Mtges	612	618	99.10	251	100.24		100.00%	100.00%	10
Whole Loans		1,004		346				100.00%	61
AAA	273	173	63.41				100.00%	100.00%	3
Sub	173	90	60.45				39.46%	39.46%	0
Securities		263						79.28%	4
Residuals		40							
Servicing Rights		7							
Total		1,314							65

Whole Loans	The performing whole loan population was price tested using a combination of recent trade activity and the average marks of other dealers. The non performing whole loan population was price tested using recent trade activity.
Securities	Third-party marks where available. Intex Desktop is utilized when no vendor mark is available. Deal specific loss and prepayment assumptions are utilized in price testing. Spreads are determined utilizing published sources such as JP Morgan monthly report as well as spreads on ABX.

Residential Mortgages Europe summary

(in $ millions)

	Q2 2008								
	Balance Sheet Positions			Transactions		Price Testing Results			
						Third Party and Recent Trade Pricing	Modeled Pricing	Testing Coverage	Testing Variance
	Balance	MV	Mark	Sales MV	Avg Px				
UK loans (including MF08-1)	2,440	2,168	88.85				70.00%	70.00%	23
IRE loans	296	288	97.30				96.00%	96.00%	2
NL loans	389	383	98.46				100.00%	100.00%	(9)
IT loans	201	179	89.05	773	96.50		100.00%	100.00%	
NPLs	1,584	633	39.96				100.00%	100.00%	
Whole Loans	4,729	3,651	77.21					81.87%	16
AAA	4,601	4,463	96.98	80	99.30	100.00%		100.00%	(112)
Sub	1,125	792	70.41	12	80.80	87.00%		87.00%	78
Securities	5,726	5,255	93.18					98.04%	(34)
Residuals		436							
Total		9,342							(18)

Whole Loans	**Mock securitization based on average prices by region, rating and collateral type obtained from Markit Partners pricing files.**
Securities	**Pricing matrix compiled using detail pricing files received from Markit Partners.**
Residuals	**Internal model utilizing collateral specific assumptions for prepayment, loss and severity.**

Leveraged acquisition financing

Leveraged Loans – Write downs and market events

We took gross write downs of $300 mm on Leveraged loans during Q2 compared to $700 mm in Q1.

◆ Home Depot Supply Bulk Sale

  – We sold $1.2 B of this asset in a bulk sale which generated a loss of $110 mm largely due to the liquidity premium related to the size of the transaction

◆ Syndication Activity

  – We had several names - CDW, Education Media and Endemol which gained price transparency due to the syndication process and generated a loss of close to $150 mm.

Leveraged Acquisition Financing – Roll Forward Analysis

◆ The decrease of $6.4bn from $17.9bn to $11.5bn in the quarter is made up of dead deals and deals done away of $1.4bn, syndicated and paired down prior to closing of $1.1bn, closed deals and sales of $3.9bn while only 1 new deal for $25mm was added for the quarter.

Roll Forward of Funded, Unfunded and Contingent Commitments
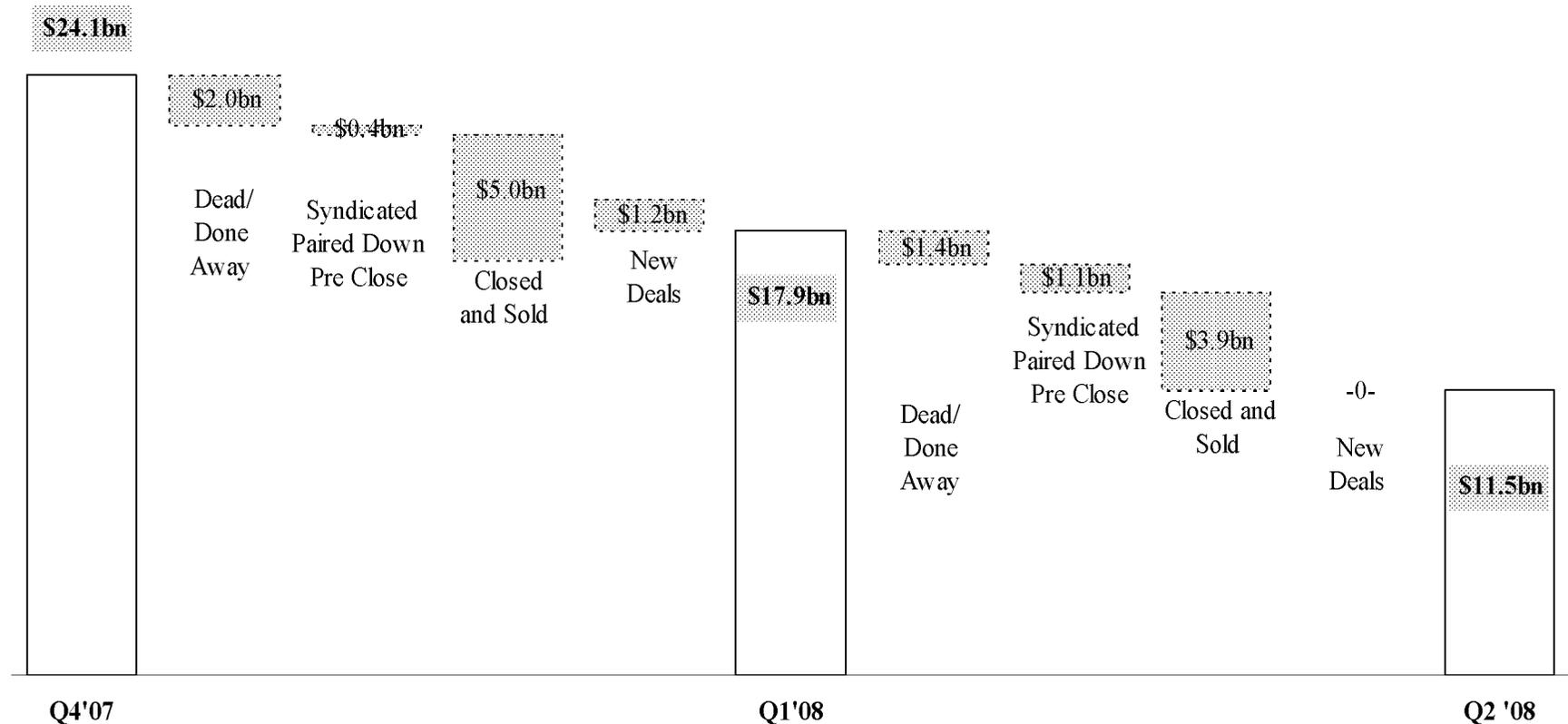
Price Verification Methods for Acquisition Facilities

◆ We utilize 4 basic price verification methods in order of hierarchy.

- External Quotes: We refer to the average bid price from LSTA or Markit partner at month end
  - (LSTA provides the average quotes from contributors with a cut off time at 3pm daily. If LSTA receives more than 3 sources, the final mark is the average of the second and third highest bid quote.)
- Trading Activity: we refer to the trade price up to 1 week before month end.
- CDS Matrix*: Calculate the implied price based on the yield by adding the various spreads (LCDS, CDS, or Sector) on top of LIBOR.
- CR Matrix*: Build yield using a generic credit curve for the issuers rating and industry on top of LIBOR.

◆ CDS/CR Matrix input assumptions

- Yield = CDS/CR Spread + Libor
- Maturity: If the final maturity is less than 1 year, we use the actual maturity. If the final maturity is greater than 1 year, then 60% of the stated maturity is used. This assumption is made the loan is quite likely to be refinanced for various economic (ie. Favorable interest rate, ratings upgrade) and uneconomic reasons (ie. M&A, desire to maintain constant maturity, diversify debt mix).
- Coupon = Weighted average of unfunded/funded amounts * unfunded/funded spreads

◆ Market Value and Coverage By Method.

Primary Method	Market Value	Coverage
CDS matrix	1,525	12%
CR matrix	940	7%
External quotes	2,291	18%
IRR Model	2,721	22%
Not Tested (Asia)	54	0%
Other	1,592	13%
Price Flex	2,996	24%
Trading Activity	479	4%
Grand Total	12,598	100%

Leveraged Acquisition Facilities Valuation Testing – Q2 ,2008

All figures in $ MM

Deal Name	Funded	Unfunded	Contingent	Notional	MV	Desk's Mark	PCG's Mark	Primary Method	Variance
ACTS	70	22	-	93	77	83.40	81.92	External quotes	(1.37)
Alliance Atlantis	-	10	-	10	9	90.00	96.66	CR matrix	0.66
Allison	1	82	-	83	70	85.00	85.67	External quotes	0.55
Archstone	2,376	155	-	2,531	2,475	97.81	97.81	Price Flex	0.10
ARINC	150	43	-	192	169	87.96	87.96	External quotes	0.00
Arysta	48	7	-	55	54	98.00		Not Tested (Asia)	
Asurion	3	22	-	25	22	86.00	87.11	CR matrix	0.28
Biomet, Inc.	-	42	-	42	39	93.12	93.70	CDS matrix	0.24
CDW	467	29	-	496	410	82.58	82.33	External quotes	(1.24)
Cenveo	90	-	-	90	90	100.00	100.00	External quotes	-
Chevron (Delek)	135	23	-	157	148	94.27	95.00	Agreed takover by Freenet - Debt will be restructured and 1st phase syndication will start next week - Strategy is to sell at par less 2% fees (98)	1.15
Dana Corporation	16	48	-	64	64	99.25	96.66	CR matrix	(1.66)
Debitel	277	53	-	330	314	95.00	95.00	Agreed takover by Freenet - Debt will be restructured and 1st phase syndication will start next week - Strategy is to sell at par less 2% fees (98)	(0.00)
Endemol	485	138	-	622	467	75.00	75.00	Marketing at the moment - Informal price discussions with investors in th 80's, investor feedback is mid 70's, subsequently sold	(0.01)
FairPoint	165	102	-	267	236	88.34	87.61	External quotes	(1.96)
First Data	583	253	-	836	724	86.65	85.59	Trading activity / CDS Matrix	(8.89)
Hawaiian Tel YP	306	5	-	311	243	78.21	71.81	CDS matrix	(19.89)
Hawaiian Telcom	4	2	-	6	5	78.50	77.75	External quote/CDS matrix	(0.05)
HD Supply	227	278	-	505	447	88.50	88.46	Loan and Bond - External quotes	(0.22)
Hilton	1,203	-	-	1,203	1,112	92.44	92.45	Internal Model	0.17
Houghton Mifflin	458	75	-	533	451	84.61	84.00	Trading Activity	(3.23)
Icopal	238	33	-	271	198	73.01	73.00	Discussing with some investors - Sold some B & C at 82 in early May (we have this marked at 80)	(0.04)
Local Insight Regatta	4	2	-	6	6	95.00	94.05	CR matrix	(0.06)
LTSB	401	48	-		449	387	86.24	86.20	Discusions with the sponsor (Advent) to buy back the debt (95% chance) - We will provide loans to advent (25% cash 75% debt) - Entire position will go, no indication on price yet	(0.19)
McJunkin	158	-	-	158	142	90.00	96.52	CDS matrix	10.27
Metavante	-	30	-	30	28	92.00	92.25	Trading Activity	0.08
O'Reilly Automotive			300	300	300	100.00	100.00	CR matrix	-
PHS	43	47	-	89	78	86.98	86.73	External quotes	(0.23)
PQ Corp	360	27	100	487	439	90.23	92.13	External quotes	9.27

Leveraged Acquisition Facilities Valuation Testing – Q2, 2008 Cont'd

All figures in $ MM

Deal Name	Funded	Unfunded	Contingent	Notional	MV	Desk's Mark	PCG's Mark	Primary Method	Variance
R.J. O'Brien	47	-	-	47	31	67.00	66.00	LSTA Quote	(0.47)
Sequa	194	121	-	315	295	93.79	93.92	CDS matrix	0.40
Sheridan HC	5	21	-	26	22	85.00	83.91	External quotes	(0.28)
Syniverse	1	27	-	28	26	92.40	92.68	CDS matrix/ CR Matrix	0.08
Targa	94	-	-	94	78	83.50	84.00	External quotes	0.47
Tribune	4	36	-	40	27	67.28	72.92	External quotes	2.27
TXU	303	287	-	590	540	91.54	92.96	External quotes/CR Matrix	8.36
USIS	7	51	-	59	51	87.00	86.22	CDS matrix	(0.46)
Varel	9	14	-	22	20	92.91	96.00	External quotes	0.68
Vertrue	78	8	-	86	68	79.67	84.00	External quotes	3.71
Wesco Aircraft			25	25	25	100.00	97.50	External quotes	(0.63)
Windstream	-	4	-	4	4	95.00	97.52	External quotes	0.10
									-
Total High Yield	**9,004**	**2,143**	**425**	**11,572**	**10,388**	**89.77**			**(2.03)**

Commercial Real Estate

Commercial Real Estate – Write downs and market events

The Firm took gross write downs of $900mm in Q2 compared to $1,400mm in Q1

◆ Floating rate commercial assets continued to weaken with spread widening leading to a loss of $400mm in the quarter

◆ In addition, the Firm took write downs of $500mm on Archstone and the Suncal portfolio. The Archstone write down was largely on the bridge equity which has not been syndicated. The SunCal portfolio consists of 24 residential land development projects, primarily located in Southern California. The write down has been due the weakness in the residential market in that area

Commercial Real Estate – Price verification methodology

◆ Price Verification is performed on a monthly basis

◆ Generally, third party pricing inputs are used where available

◆ The principal book (PTG) is price verified using a NPV approach with a significant emphasis on the credit qualities of each collateral. Our models use:
  – Property level information provided by third party servicers (Trimont & PCCP). Information received includes position attributes, collateral valuation and current update commentary.
  – Discount rates are derived from third party publications (Institutional Investors' Real Estate Finance & Investments)
  – Product Control also reviews IRR models developed for each position by Trimont for reasonableness

◆ Bridge equity generally marked to target investor yields for the specific investment. Product Control reviews / discusses the reasonableness of the valuation assumptions.

◆ The commercial book is price verified using internal models based on spreads obtained from third party publications giving special emphasis to recent sales, circles and bids on notes of similar attributes (LTV, property type, location, etc).

◆ Product Control holds regular discussions with the business senior management to discuss pricing variances that exceed our established thresholds. Based on the results of the price verification review, PC recommends/ suggests mark adjustments. Those positions are either remarked or adequate justification or support is provided by the business to support the existing mark.

Commercial Real Estate - US

(in $ millions)

	Q2 2008				
	Balance	**MV**	**Mark**	**Sales MV**	**Avg Px**
Senior	11,810	10,674	90.4	1,593	92.4
Mezz	5,267	4,591	87.2	1,280	89.9
Equity	6,459	4,484	69.4		
NPL	322	198	61.4		
Securities Bonds	851	589	69.2	1,645	91.1
Securities IOs	28,283	319	1.1	16	1.4
Commercial mortgage and real estate related investments		20,854		4,534	
Senior	3,330	3,245	97.4	195	94.3
Mezz	523	474	89.7		
Financing trades	397	397	100.0		
Revolver	402	392	97.4		
Corporate Debt		4,508			
Corporate Equity	2,223	1,659	74.6		
Total		27,021		4,713	

Commercial Real Estate - Europe

(in $ millions)

	Q2 2008			Sales MV	Avg Px
	Balance	**MV**	**Mark**	**Sales MV**	**Avg Px**
First	4,693	4,586	97.7	425	98.1
Second	121	114	94.5		
Mezz	764	734	96.0	482	97.9
NPL	105	43	41.3	-	
Equity	1,563	1,474	94.3	-	
Securities	3,942	3,769	95.6	1,320	96.1
Commercial mortgage and real estate related investments		10,720	95.8	2,227	
Corporate Debt	1,748	1,747	99.9		
Corporate Equity	59	59	100.0		
Total		12,526		2,227	

Commercial Real Estate - Asia

(in $ millions)

	Q2 2008				Sales MV	Avg Px
	Balance	**MV**	**Mark**		**Sales MV**	**Avg Px**
Senior	4,210	4,053	96.3		593	99.3
Mezz	589	583	99.0			
Equity	1,213	1,156	95.3			
NPL	19,040	1,670	8.8			
REO	74	71	95.9			
Securities	606	601	99.2			
Commercial mortgage and real estate related investments		8,134				
Corporate Debt	678	669	98.7		10	100.0
Total		8,803			10	