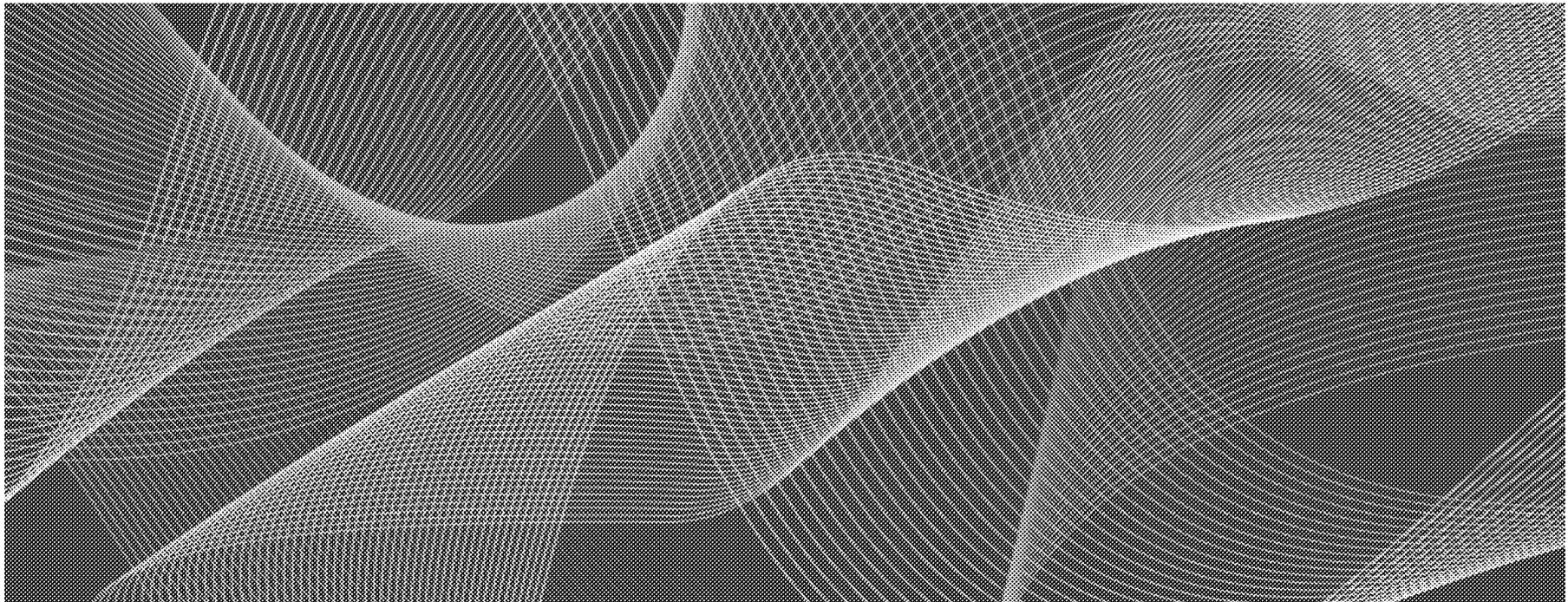




FSA Arrow Assessment - Treasury



Confidential Presentation

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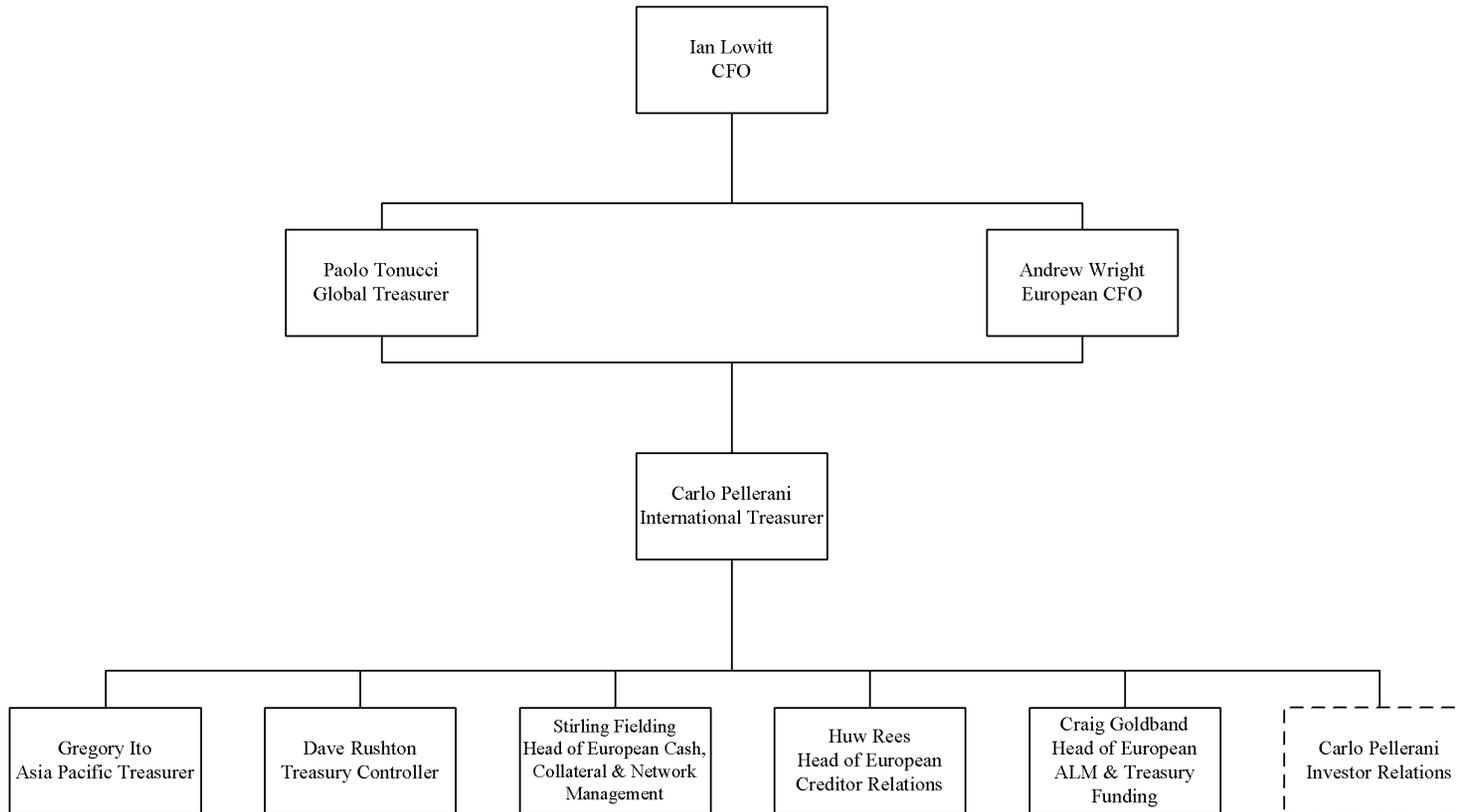
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LEHMAN BROTHERS

The Treasury Function

Global Treasury is part of the Finance function

The Global Treasury function reports locally and globally into the Chief Financial Officer



Global Treasury Disciplines Overview

Global Treasury's primary responsibility is to keep the firm safe from a liquidity standpoint, to fund all business needs and to ensure effective use of the Firm's capital

Asset Liability Mgmt	<ul style="list-style-type: none">◆ Manages key corporate treasury risks of liquidity, interest rate and foreign currency◆ Manages funding and capital structure issues◆ Develops liquidity management policy and projects and monitors liquidity◆ Funds business activities and manages the liquidity pool
Cash & Collateral Mgmt	<ul style="list-style-type: none">◆ Establishes controls and processes to efficiently manage intra-day liquidity requirements at an optimal cost◆ Provides secured and unsecured funding forecasts; monitors, reconciles and adjusts for changes based on real-time settlement activity
Financial Planning & Analysis	<ul style="list-style-type: none">◆ Responsible for effective management of equity capital◆ Manages relationships with credit rating agencies◆ Provides analyses to senior management to support decision making on financial policy
Creditor Relations	<ul style="list-style-type: none">◆ Establishes and maintains relationships with credit providers and communicates credit profile◆ Builds relationships with creditors to ensure access to reliable credit in all market environments
Treasury Controllers	<ul style="list-style-type: none">◆ Works with Product and Legal Entity Controllers to manage and report interest expense◆ Ensures that the expense of secured and unsecured funding is accurately allocated◆ Manages various aspects of non-dollar equity, P/L and FAS 133 / FAS 157 / FAS 159 processes
Network Management	<ul style="list-style-type: none">◆ Negotiates and tracks fee arrangements to securities/cash clearing service providers◆ Manages service relationships◆ Acts as an internal consultant to businesses looking to enter new markets or launch new products◆ Is the expense line owner for clearance expenses Firm-wide

The Funding Framework

Introduction¹

- ◆ Liquidity risk management is of critical importance to Lehman Brothers, providing a framework which seeks to ensure that the Firm maintains sufficient liquid financial resources to continually fund its balance sheet and **meet all of its funding obligations in all market environments over a 1 year time-frame.**
- ◆ Governance plays a key role. The **weekly Global Finance committee**, which comprises senior members of the finance function, reviews our key liquidity metrics to ensure we are in constant compliance with our liquidity standards.
- ◆ From 1st Jan 2006 Lehman Brothers Holding Inc has been subject to Consolidated Supervision, under SEC regulation. **SEC the FED, and Ratings Agencies** review Lehman Brothers liquidity readiness on a regular basis and have praised Lehman Brothers for being at the forefront of liquidity risk management within the broker dealer sector.
- ◆ The conservativeness embedded in the Funding framework (e.g., fund boxed positions with cash capital, irrespective of the liquidity characteristics of the positions) is what **distinguishes** the Firm's Framework from that of our peers.

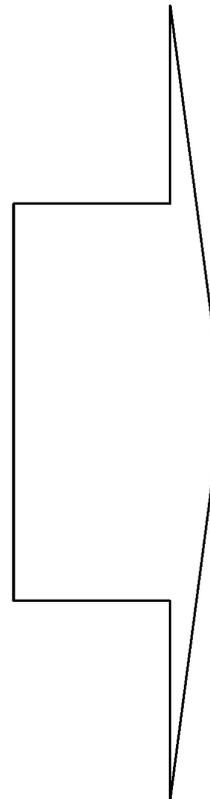
1. All figures are as of 31 May 2008 unless otherwise indicated.

Core Principles of Liquidity Management

Our liquidity management is based on four principles.

Liquidity Strategy Principle

- ◆ We must remain in a constant state of liquidity readiness
- ◆ We should not rely on asset sales or increases in unsecured borrowings or funding efficiencies in a liquidity crisis
- ◆ We should not overestimate the availability of secured financing in a liquidity crisis
- ◆ Legal entity structure constrains liquidity flows which should be explicitly accounted for in liquidity planning



Implication to Funding Framework

- ◆ Maintain a **large cash position** in the Holding Chain, sufficient to absorb the impact of a very severe liquidity event
- ◆ **Do not plan on reducing balance sheet for liquidity reasons** in a liquidity event (although may do so for risk reasons)
- ◆ Establish '**Reliable Secured Funding**' levels by asset category by counterparty
- ◆ Separate Cash Capital Model for each **regulated entity** and the Holding Chain; treat all excess cash in restricted entities as 'trapped'

Four Pillars Of The Funding Framework

These principles translate into four pillars of the liquidity framework:

1. Size of our **liquidity pool**

- Our policy is to maintain a liquidity pool which covers all expected outflows over a one year period.

2. Our long-term funding sources and requirements (**‘Cash Capital’**):

- Cash Capital concept represents funding with a maturity beyond one year.
- Less liquid assets will be funded with Cash Capital.
- Target surplus cash capital of \$4-7bn on an ongoing basis.

3. Our **reliable secured funding** capacity:

- In a liquidity event Lehman anticipates a contraction in the availability of secured funding – especially for less liquid assets.
- The Reliable Secured Funding Model (RSFM) incorporates our conservative assessment of the completely reliable secured capacity, by asset class, we anticipate in a liquidity event.

4. Our **contingency funding plan**:

- When a crisis is identified the Contingency Funding Plan is initiated.
- Key Treasury and reporting responsibilities are assigned.

Liquidity Pool - Basics

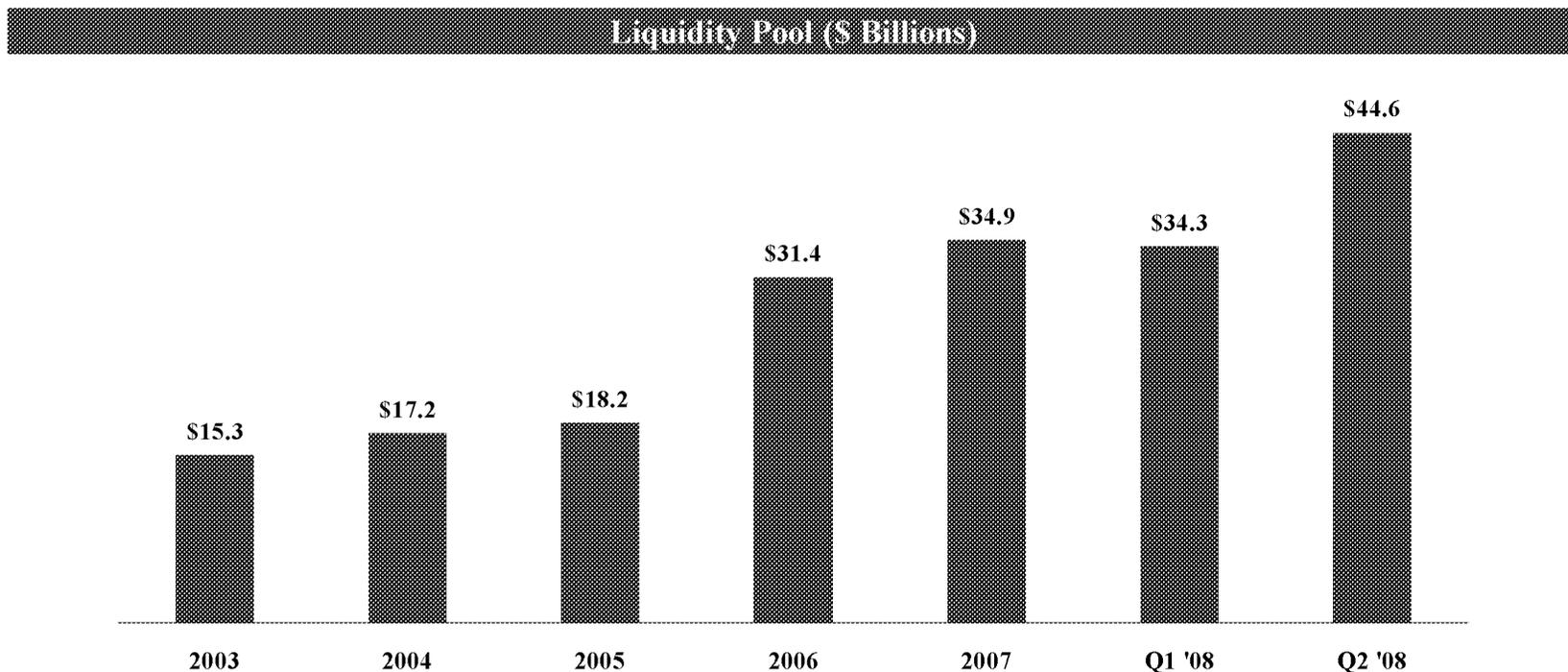
- ◆ Our policy is to maintain a liquidity pool that covers, in stressed liquidity environment, all expected cash outflows for one year (**Maximum Cumulative Outflow – ‘MCO’**).
- ◆ These projected outflows are re-assessed **weekly** and as they change we adjust the size requirement for the liquidity pool.
- ◆ This liquidity pool is **invested** in
 - Cash and money market instruments
 - Good quality collateral for which there is ample unused funding capacity with external counterparts
 - Investment grade securities (Treasuries, Agencies, Corporates and Asset-Backed Securities)
 - Major index equities
- ◆ Because most of the unsecured debt is issued out of Holdings, the most important liquidity pool is that of Holdings and its Unrestricted Subsidiaries (**‘the Holdings Chain’**).
- ◆ The liquidity of the **Restricted subsidiaries** is separately managed to comply with their applicable liquidity and capital requirements and to minimise dependence on the Holdings Chain.

Sizing the Liquidity Pool

- ◆ Drivers of Liquidity Pool requirements:
 - a. **Repayment of all unsecured debt** of Holdings and its Unrestricted Subsidiaries maturing within twelve months. We assume that, in a stressed liquidity environment, we will have no access to the unsecured debt market for a full year.
 - b. **Drawdown of commitments** to extend credit made by the Holdings Chain based on an analysis of the probability of such drawdown and the unused funding capacity of special funding vehicles set up to mitigate contingent liquidity risk.
 - c. **Reduced secured funding** through either widening of market haircuts or disappearance of repo counterparties due to stress market conditions.
 - d. **Additional collateralisation** of derivative contracts and other secured funding arrangements by the Holdings Chain to counterparties that would be required in the event of a rating downgrade/crisis event and.
 - e. **Funding of debt and equity repurchases** as we manage our equity base. This would include the equity buybacks required to offset the dilutive effect of our employee incentive plans.
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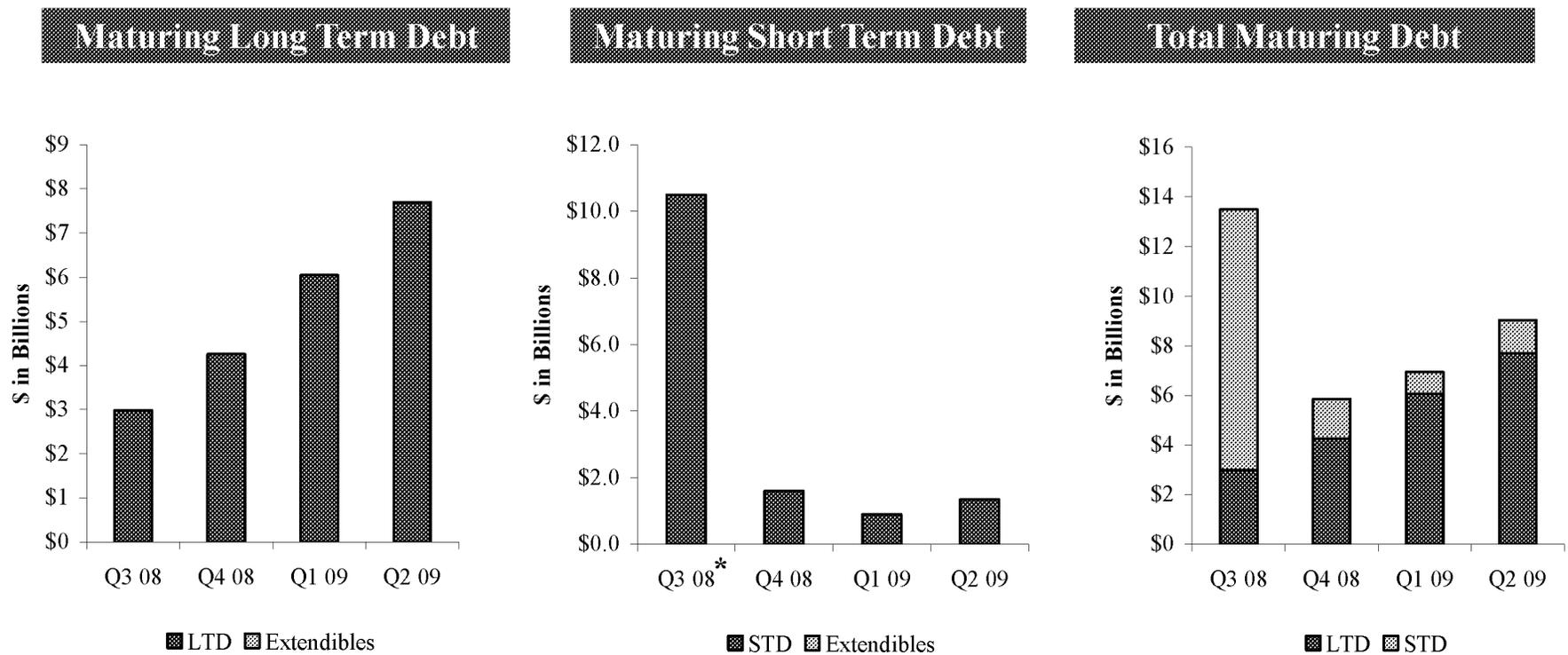
Liquidity Pool

- ◆ The Liquidity pool is managed by Treasury for the Holding Company.
- ◆ Not included in the liquidity pool are unencumbered assets (\$61 billion in unregulated subsidiaries and \$87 billion in regulated subsidiaries as of May 31) and the liquidity pools held at the bank entities and broker dealers.
- ◆ Finished Q2 '08 with a record liquidity pool of \$44.6 billion.



a) Monitoring the Maturity Profile

- ◆ We quantify and continually monitor our maturities occurring within the next 12 months.
- ◆ Total Maturing Debt within the next 12 months = \$35bn



* Increased CP balances to \$7.9bn as a mitigant to short term fluctuations such as unforeseen operational friction (fails), a sudden drop in prime broker lock-ups or sudden changes in secured funding

b) Liquidity Risk Of Unfunded Loan Commitments

High grade and high yield loans behave differently. We therefore separate High Grade From High Yield Loan Commitments

- ◆ High grade facilities
 - Rarely drawn; however usually they are almost fully funded when they draw
 - High liquidity risk
 - Large individual commitments
 - Unpredictable draws at a portfolio level
 - In a market-wide liquidity event, otherwise creditworthy borrowers may draw on their facilities because they are unable to access the capital markets, or to stockpile cash

- ◆ High yield revolvers
 - Secured line of credit with stringent covenants usually used for working capital purposes
 - Usually fully (or close to fully) funded
 - Medium liquidity risk
 - Small individual commitments
 - Predictable draws at a portfolio
 - Low correlation between draw and Lehman liquidity event

b) Liquidity Risk Of Unfunded Loan Commitments

Prefunding of High Grade Facilities is based on a number of factors.

- ◆ Liquidity risk is mitigated by prefunding some of the facilities based on:
 - **Rating of the borrower** – The higher the rating is, the less likely the borrower is going to draw its facility. The percentage is a stress case of downgrade probabilities.
 - **Industry concentration** – The more concentrated the CP backstop portfolio is, the larger the liquidity risk and, therefore, the pre-funding requirement
 - **Size of the facility** – The bigger the facility is, the higher the concentration liquidity risk and, therefore, the pre-funding requirement

Prefunding Level			
Rating	Industry		
	Green	Yellow	Red
AA and above	0%	0%	5%
A	5%	10%	15%
BBB	20%	25%	30%
Below BBB	100%	100%	100%

Industry classification	
Green	Healthcare, real estate, retail, technology
Yellow	Consumer products, industrial
Red	Energy / power, financials, media/telecom

Prefunding Level (Incremental amount above \$250 Million)			
Rating	Industry		
	Green	Yellow	Red
AA and above	12.5%	12.5%	10%
A	15%	12.5%	10%
BBB	15%	12.5%	10%
Below BBB	0%	0%	0%

High Yield Revolvers have lower liquidity risk.

- ◆ High yield facilities will be pre-funded at 20%. This recognizes the working capital versus liquidity backstop nature of these facilities.
- ◆ We have calculated that a 20% prefunding is more than 23x the standard deviation of the draws on our diversified High Yield revolver portfolio.

b) Liquidity Risk Mitigation of Unfunded Loans

The Firm mitigates the liquidity risk in the event these loans draw through prefunding and funding vehicles:

- ◆ In aggregate the Firm has set aside \$4.7bn (\$1.8bn in the holding company) as of May 2008 for prefunding of its contingent loan commitments as part of its cash capital model.
 - Lehman Brothers Bankhaus \$758m
 - Lehman Brothers Bank \$1.2bn
 - Lehman Brothers Commercial Bank \$892m
 - Lehman Brothers Holdings Inc \$1.8bn

- ◆ The Firm owns three bank entities: Lehman Brothers Bank, LBCB, and Bankhaus which operate in a deposit-protected environment and are able to source low-cost unsecured funds that are primarily term deposits. These are generally insulated from a company specific or market liquidity event and provide a reliable funding source.

c) Haircut Widening

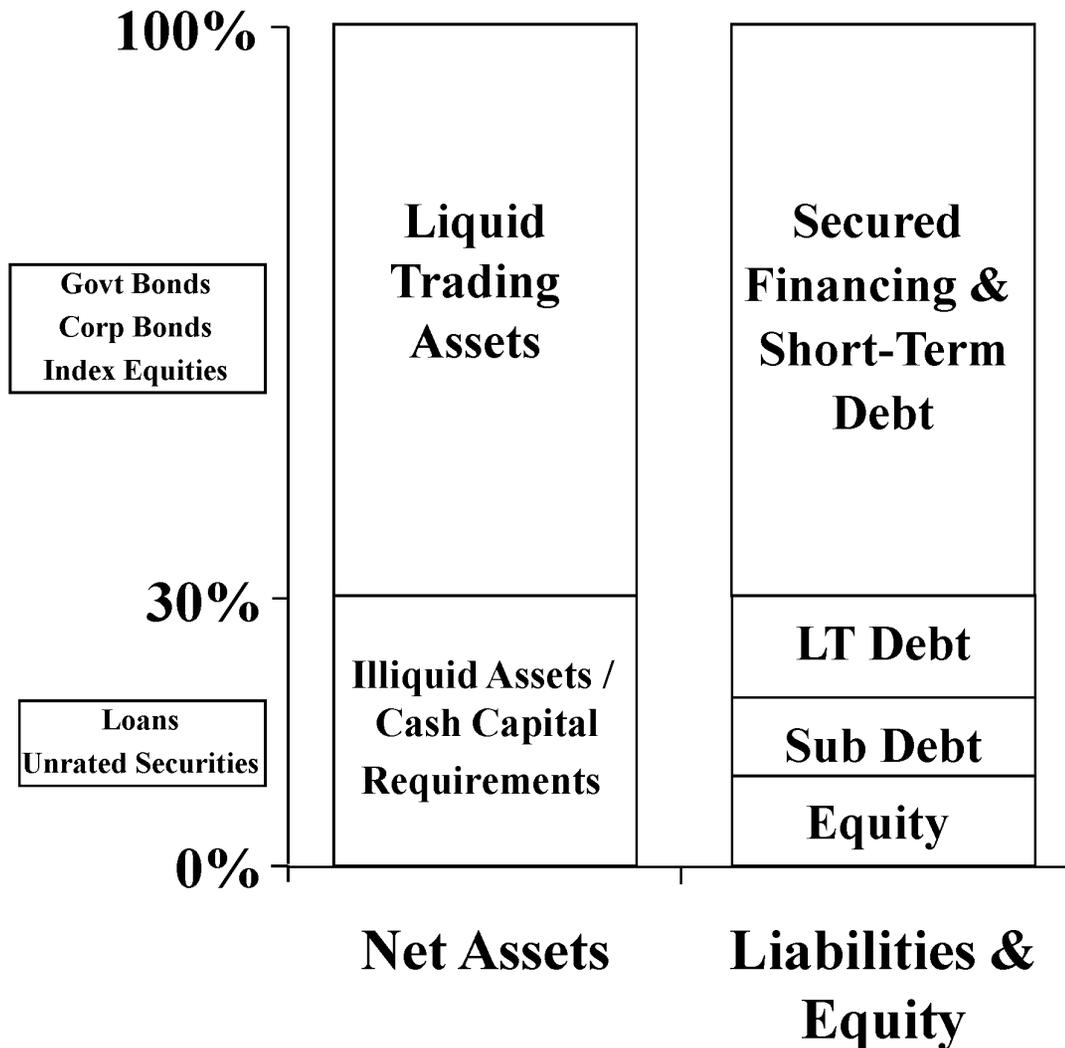
- ◆ In a liquidity event, Lehman Brothers assumes a widening of haircuts required by counterparts for secured financing to better protect themselves against economic losses (in a market wide liquidity event for example, we would expect asset prices to be more volatile than usual). The haircut widening is the difference between the normal market haircut and the stress market haircut, which we estimated based on discussions with traders and counterparts as well as on our past experience. See table below for examples.

Sample Haircuts - Normal Market / Stress Environment

Asset Category 1	Asset Category 2	Normal Market Haircut	Stress Market Haircut	Haircut Widening
Corporate	AAA	5.0%	10.0%	5.0%
Corporate	BB	5.0%	27.0%	22.0%
Equity	Common Stock	5.0%	12.0%	7.0%
Eurobond	Fixed Rate	5.0%	10.0%	5.0%
Sovereign	Eurobond	5.0%	18.0%	13.0%

- ◆ The difference in the stress market haircut and normal market haircut represents the expected loss of liquidity for each asset class. This expected loss of liquidity is covered by the Firm's liquidity pool.

Cash Capital Requirements



- ◆ Liquid Trading Assets are predominantly financed through secured repo financing.
- ◆ Illiquid Assets (Cash Capital assets) are financed with long term sources of funding (>1yr) :
 - Equity: Meet target Leverage Ratios and acceptable ROE
 - Sub Debt: Meet Target CSE Capital Ratios
 - Long Term Debt

Cash Capital Uses

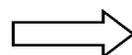
All unsecured funding requirements in normal operating conditions require cash capital

	Examples	Cash Capital Principle
Illiquid positions	<ul style="list-style-type: none"> ◆ Corporate and commercial whole loans ◆ Long-term non-trading assets ◆ Exchange margin & other LT collateral ◆ Fixed income, equity derivative and FX 	<ul style="list-style-type: none"> ◆ Funded 100% with cash capital ◆ Determine whether a position is illiquid by looking at its fundability in a stress liquidity event
Secured haircuts on long inventory	<ul style="list-style-type: none"> ◆ Reverse repo agreements and borrowed securities ◆ Collateralized funding to counterparts 	<ul style="list-style-type: none"> ◆ Cash capital charge dependent on asset haircut ◆ Haircuts conservatively estimated and regularly reviewed ◆ If asset cannot be reliably funded on a secured basis in a liquidity event, the haircut assessed against the asset is 100%
Operational friction	<ul style="list-style-type: none"> ◆ Inventory in the “box” ◆ Cash at banks 	<ul style="list-style-type: none"> ◆ Unsecured financing assessed a “box” charge irrespective of liquidity characteristics ◆ Cash at banks deemed not to be freely available to Holdings
Legal entity trapped	<ul style="list-style-type: none"> ◆ Intercompany margin postings ◆ Structural trapped liquidity 	<ul style="list-style-type: none"> ◆ Margin posted by other entities into regulated entities ◆ Surplus cash due to regulatory capital requirements
Contingent liquidity	<ul style="list-style-type: none"> ◆ CP backstops ◆ High-yield revolvers ◆ Secured lines of credit 	<ul style="list-style-type: none"> ◆ Prefund unfunded loans to mitigate contingent liquidity risk ◆ Revolvers typically include covenants that prevent draws in distressed market events
“Match funding”	<ul style="list-style-type: none"> ◆ Integrated transaction on asset and liability side 	<ul style="list-style-type: none"> ◆ Asset and liability have self-funding and self-liquidating characteristics ◆ Structures reviewed on an individual basis

Cash Capital Sources

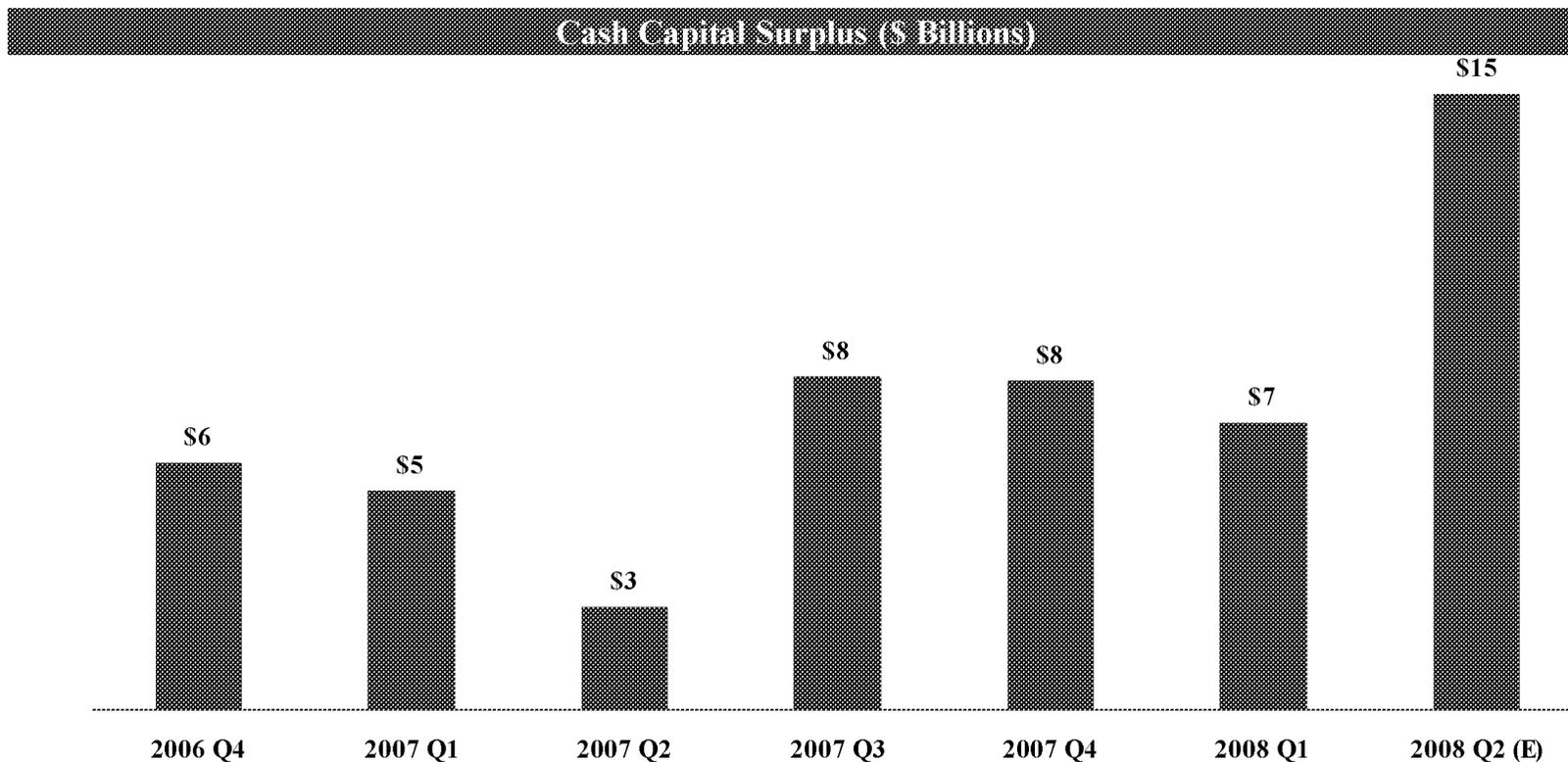
Target cash capital sources to exceed uses by \$4 - \$7 billion on an ongoing basis

	Examples	Cash Capital Principle
Equity and long term debt	<ul style="list-style-type: none"> ◆ Equity ◆ Preferred and trust preferred ◆ Long term debt with remaining term > 1yr 	<ul style="list-style-type: none"> ◆ Limit amount of maturing debt over any rolling three, six and twelve month horizon (12.5%, 17.5% and 30.0% of total, respectively) ◆ If debt limits are exceeded, do not recognize excess as reliable liquidity ◆ Source diversity by limiting individual aggregate holdings to 5% of Lehman Brothers' total debt outstanding
Cash capital structures	<ul style="list-style-type: none"> ◆ Evergreen structures ◆ Non-extendible structures ◆ Structured notes 	<ul style="list-style-type: none"> ◆ Extendible secured and unsecured structures with terms > 1yr ◆ Structures with completely reliable funding with remaining terms >1 yr
Restricted entity cash capital	<ul style="list-style-type: none"> ◆ Certificates of deposit ◆ Schuldschein 	<ul style="list-style-type: none"> ◆ Liabilities with insurance wrap
Committed facilities	<ul style="list-style-type: none"> ◆ Revolving credit facilities 	<ul style="list-style-type: none"> ◆ \$2.0 billion U.S. and \$2.5 billion European syndicated facilities ◆ Routinely drawn and repaid for working capital purposes ◆ Average utilization is 33-50% ◆ Included as a source only when drawn

 No reliance on hot money such as customer free credits or short term debt as a cash capital source

Cash Capital Surplus

- ◆ Holdings' cash capital surplus historically fluctuated in a range of \$2 - \$6 billion. During the summer of 2007, the Firm conservatively increased the target to \$4 - \$7 billion
- ◆ Finished the quarter with record cash capital surplus of \$15 billion



The Legal Entity Structure

- ◆ The legal entity structure of a financial institution is of critical importance with regard to mobilizing and pooling cash at the holding company to meet maturing liabilities.
- ◆ Typically, liquidity is tracked at the enterprise level. While a firm may appear to have adequate liquidity at the overall firm level, if the regulated entities are in surplus, the unregulated entities may be in deficit.
- ◆ Any surplus in regulatory Cash Capital is excluded from Global Liquidity, but regional deficits are deducted from Global Cash Capital numbers.

Hypothetical Impact of Legal Entity Structure on Cash Capital:

Illustrative

	Regulated Entities	Unregulated Entities	Total
Sources	50	50	100
Uses	40	58	98
Net Cash Capital	10	(8)	2
	↑	↑	↑
	Large Surplus in Regulated Entities	Shortfall in Unregulated Entities	Apparent Sufficiency of Cash Capital at Firm Level

Trapping Cash in Regulated Entities

Cash Capital is tracked on a weekly basis and presented to the Finance Committee

- ◆ Cash capital is calculated on a weekly basis and a cash capital schedule is included in the weekly package discussed at the Finance Committee.

- ◆ The schedule shows the cash capital by division and major funding entities (the data for LBHI include all unregulated entities) as well as the weekly variance.

In \$mm	30 May 2008						WOW May-30 vs. May-23					
	LBJ	Eur Reg Group	LBI	LOTC	LBHI	Adjusted Total (note 3)	LBJ	Eur Reg Group	LBI	LOTC	LBHI	Adjusted Total
Sources												
LTD	-	826	467	-	113,515	114,808	-	-	-	-	(511)	(511)
LTD - Gross-up for Self-funding Trades	-	-	-	-	92	92	-	-	-	-	-	-
Equity	835	7,310	4,112	370	18,788	31,415	-	-	-	-	(430)	(430)
Traditional CC Sources	835	8,136	4,579	370	132,395	146,315	-	-	-	-	(941)	(941)
LBI Investment in Unregulated Subs	-	-	(1,262)	-	1,262	-	-	-	(500)	-	500	-
Intercompany Funding from Holdings	-	-	-	-	-	-	-	-	-	-	-	-
Intercompany Subdebt	760	10,207	6,550	250	-	-	-	(700)	-	-	-	-
Reg-T Margin	-	-	2,768	-	-	-	-	-	(0)	-	-	-
Drawn Facilities	-	-	-	-	8,193	8,193	-	-	-	-	350	350
Secured Extendible Facilities	-	1,374	-	-	1,774	3,148	-	-	-	-	-	-
Total Sources	1,595	19,717	12,635	620	143,624	157,656	-	(700)	(500)	-	(91)	(591)
Uses												
Total FID	842	8,324	9,233	-	77,430	95,829	81	63	307	-	(4,297)	(3,847)
Total EQ	296	3,936	1,888	657	4,488	11,265	(27)	(116)	137	(289)	(1,122)	(1,417)
Other Divisions	452	3,225	3,231	17	12,925	19,851	(21)	(4)	424	(2)	(1,606)	(1,209)
Non Trading Assets (note 1)	382	1,566	401	-	9,184	11,533	(5)	(3)	0	-	(261)	(268)
Gross-up for Self-funding Trades	-	-	-	-	92	92	-	-	-	-	-	-
Contingent Collateralization	-	77	22	-	374	473	-	17	(12)	-	284	289
Intercompany Subdebt	-	-	-	-	17,767	-	-	-	-	-	(700)	-
Intercompany Funding from Holdings	-	-	-	-	-	-	-	-	-	-	-	-
Reg-T Margin	-	-	-	-	2,768	-	-	-	-	-	(0)	-
FX Revaluation	-	-	-	-	0	0	-	-	-	-	(185)	(185)
Pending Loan Syndication	-	-	-	-	(2,238)	(2,238)	-	-	-	-	280	280
Other Cash Capital Usage	-	-	-	-	1,000	1,000	-	-	-	-	-	-
LB1 Group Box Adjustment	-	-	-	-	1,611	1,611	-	-	-	-	-	-
Other Box Updates	-	-	-	-	2,000	2,000	-	-	-	-	-	-
Rehypothecable Client Collateral	-	-	-	(376)	-	(376)	-	-	-	-	-	-
Reduction in Contingent Commitments	-	-	-	-	(298)	(298)	-	-	-	-	155	155
Total Uses	1,971	17,129	14,776	298	127,104	140,741	28	(43)	856	(291)	(7,452)	(6,203)
Cash Capital Position before I/C	(376)	2,589	(2,140)	322	16,520	16,914	(28)	(657)	(1,356)	291	7,360	5,611
Trapped Cash Capital (bonus)	-	661	616	-	(661)	616	-	-	-	-	-	-
Intercompany Margin	-	(2,400)	2,400	-	-	-	-	-	-	-	-	-
Other Intercompany	796	340	965	173	(2,274)	-	162	(1,058)	(466)	-	1,362	(0)
Cash Capital Position after I/C	420	1,190	1,841	495	13,585	17,530	134	(1,715)	(1,822)	291	8,722	5,611
Repayment of Reg Entity Intercompany	(420)	-	(965)	(173)	1,558	-	(134)	933	466	-	(1,265)	0
Covering of Reg Entities CC Shortfall by LBHI	-	129	-	-	(129)	-	-	129	-	-	(129)	-
Net Cash Capital Position	-	1,319	876	322	15,013	17,530	-	(652)	(1,356)	291	7,328	5,611

Reliable Secured Funding (RSF)

The Reliable Secured Funding Model (RSFM) sets strict rules to mitigate the liquidity risk of secured funding

- ◆ Assets for which reliable secured funding exists across all market environments are funded on a secured basis.
- ◆ By its nature, secured funding is seen as being safer and more reliable than unsecured funding of similar term.
- ◆ The RSF Model conservatively assesses a stressed haircut level and quantitatively measures the funding requirement if average haircuts widened to stressed levels. Average haircut widening represents the combined effect of loss of repo counterparties and increased haircuts.
- ◆ For each asset class, we perform a detailed reliability assessment of each counterparty. This assessment, which is mostly qualitative in its nature, seeks to ascertain
 - Depth and breadth of the relationship between Lehman and the counterparty
 - Whether counterparty is “comfortable” taking possession of the assets if necessary
 - Trading line that the counterparty would be willing to extend to Lehman during a liquidity event
 - Reliable secured funding capacity, measured for each asset class, is equal to the sum of trading lines of each reliable counterparty for this asset class plus the amount of evergreen funding structures for this asset class
- ◆ In conjunction with Capital Markets, we continue to develop our RSF models as we seek to complement what is essentially a qualitative process with a quantitative assessment of the probabilistic loss of secured funding capacity.

Managing Secured Liquidity Risk

- ◆ Short term secured financing represents the largest source of secured funding for the Firm. Consequently, one key objective is to ensure that these funding sources are maintained in adverse market environments
 - Do not want to put Lehman Brothers in a position where a lack of liquidity results in an impairment of the franchise
- ◆ Manage secured liquidity using a four-pronged risk mitigation strategy, which conservatively assumes: (a) no reliance on Holdings' liquidity; (b) no reliance on customer collateral or free credits

Secured Financing Risk Mitigation Strategy	
Assess reliability of funding counterparts	<ul style="list-style-type: none"> ◆ Reliability of repo counterparties are being assessed continuously on an asset class-by-asset class basis ◆ Funding is typically with counterparties, which have a long and deep funding/trading history with Lehman Brothers (e.g., clearing banks, large asset managers)
Overfund less liquid asset classes	<ul style="list-style-type: none"> ◆ Capital Markets Prime Services as a matter of policy funds more less liquid collateral than it needs, thereby creating a “cushion” in case counterparties stop funding Lehman Brothers or ask for higher quality collateral
Use of Lehman Brothers Bankhaus	<ul style="list-style-type: none"> ◆ Contrary to Lehman Brothers Bank or Lehman Brothers Commercial Bank, Lehman Brothers Bankhaus is able to fund good quality collateral (~\$3 billion) held by other Lehman entities, such as LBIE ◆ This collateral can be funded either on an unsecured basis (Bankhaus operates in a deposit-protected environment) or can be repoed to the discount window of the ECB
“Transform” balance sheet	<ul style="list-style-type: none"> ◆ In a severe liquidity event, Lehman Brothers would reduce liquidity-consuming proprietary positions, such as the Matched Book ◆ Additionally, we would use our structuring capabilities to create liquid, investment grade securities out of a pool of less liquid collateral (e.g., through CLO or CDO)

Contingency Funding Plan

Contingency Funding Plan: Summary

- ◆ A comprehensive Contingency Funding Plan is a valuable tool to manage liquidity risk, avoid potential insolvency and communicate effectively to the Firm's stakeholders during a funding crisis. The Lehman Brothers CFP projects potential funds erosion in a crisis situation and forces analysis and management outside of traditional functional levels.
- ◆ The main focus of the plan is to provide tools to manage and generate liquidity, but also highlights the importance of communication, both internally and externally, and the ability of the Firm to quickly mobilise resources and information to optimise reaction to a crisis.
- ◆ The plan directs the firm to address any weaknesses that exist by clearly defining what actions need to be carried out, who is responsible for these actions and what outcome should be expected.

Contingency Funding Plan

The Contingency Funding Plan (CFP) Is A Detailed Action Plan To Be Activated In A Liquidity Event

- ◆ The Contingency Funding Plan (CFP) includes the following components:
 - Creates an **executable plan** for a comprehensive response to extreme liquidity events by geographical region, functional area, and business
 - Defines **roles and responsibilities** within the management framework to execute the plan
 - Provides **key contact** points within and outside the firm for decision making and implementation
 - Identifies **key resources** within the firm, including senior management, information, and operational support that need to be mobilized to implement the plan
 - Incorporates a **comprehensive communication strategy** to consolidate feedback to senior management and creditor institutions.

- ◆ It was last activated in the aftermath of September 11, 2001 as a precautionary measure.
 - We did not have a liquidity event on September 11, 2001. On the other hand, we were very long cash and were able to provide liquidity to European banks that had trouble funding their dollar positions. The plan was activated primarily because of the state of disarray of the secured funding markets.

Contingency Funding Plan

Contingency Funding Plan: Treasury Requirements

- ◆ The **initial 24 hours** after the start of a crisis are expected to be critical. During this period Treasury must assess the impact that the crisis catalyst, if one exists, has on the Firm's liquidity position and planning. The key tasks required to be performed by Treasury include:
 - Preparing cash projections for LBHI (Global) funding chain
 - Estimating funding requirements for material legal entities
 - Determining maximum pledge value of Firm's unencumbered collateral
 - Identifying major gaps in liquidity and considering how to close them
 - Comparing actual market conditions to MCO assumptions/estimations
 - Evaluating FX line availability
 - Monitoring margin activity
 - Evaluating inter-company payables and possible distributions
 - Reviewing Prime broker activity
 - Review of operational friction .i.e. fails

Stressed Liquidity Scenario

Role Of Stress Funding Scenarios In Funding Framework

Stressed Liquidity Scenario

- ◆ Stress scenarios are an integral part of how we build funding frameworks
 - Liquidity pool sized to sustain a severe liquidity event
 - No unsecured debt issuance for 12 months
 - Rating downgrade
 - Draw on unfunded loan commitments
 - Cash capital policy built around funding assets in a stressed liquidity environment
 - Inventory is funded with cash capital by default. Exceptions are made only when there exists a secured funding market for an asset class that is deep and broad in all market environments
 - Secured funding plan built around a loss of liquidity in secured funding markets
 - Repo assets with counterparties that know Lehman Brothers and the assets well
 - Build overfunding cushion to mitigate loss of secured funding

- ◆ In addition, we have built a scenario modeling a significant loss of secured funding incorporating the liquidity lessons of recent market events. Objective is to **maintain a liquidity pool of at least \$10 billion during the first month** without selling assets supporting client franchise or reducing client funding

Liquidity Stress Funding Scenario - Principles

- ◆ Purpose of this stress funding scenario is to model a severe liquidity event over the course of a month. Over the course of one month, **liquidity outflows** occur due to:
 - Significant loss of secured funding capacity on non-Government or Agency securities
 - Inability to roll unsecured debt, coupled with debt buybacks
 - Rating downgrades and draws on unfunded loan commitments
 - Withdrawal of customer free credits
 - Payments on derivative margin disputes

- ◆ Offsetting these cash outflows are **liquidity risk mitigants**:
 - First and foremost, liquidity pools at Holdings, broker dealers and Lehman Brothers Bankhaus
 - Draw on our committed facilities: We draw on our committed facilities 30-50% of the time in the normal course of business, thereby removing any signalling effect that could be associated with a draw
 - Term overfunding and excess collateral borrowed, which mitigates the loss of secured funding
 - Term overfunding = Unused term repo capacity
 - Additional funding through the ECB tender auction facilities
 - Unwind of matched book positions supporting proprietary positions (\$1 billion impact)

- ◆ The following have **not been included** as “liquidity risk mitigants” in this scenario:
 - Use of the Federal Reserve’s PDCF or TSLF
 - Reduction of balance sheet impacting client-facing activities
 - Reduction of prime broker client funding

Liquidity Stress Scenario Assumptions

Stressed Liquidity Scenario

Loss of Secured Funding

◆ Repos	% Rolled	% Lost
Governments & Agencies	100%	0%
Corporates		
High Grade	70%	30%
High Yield	0%	100%
Asset Backs / Private Labels		
High Grade	40%	60%
High Yield	0%	100%
Commercial Paper Repo	70%	30%
Muni	40%	60%
Equities / Convertibles		
E1	70%	30%
E2 / C1	0%	100%
E3 / C2	0%	100%
◆ Munis TOB – 7 day put exercised on day 1		
– Customer collateral returned /liquidated over 1 week		
– Firm collateral liquidated		
◆ Prime broker		
– Free credit balances withdrawn on day 1		
◆ Dealer-based matched book		
– Unwound to release haircut (\$1.0 bn)		
◆ Central banks		
– No PDCF or TSLF		
– Able to use ECB tender facility through Bankhaus, consistent with normal practice		

Loss of Unsecured Funding

- ◆ **Unsecured debt**
 - CP and LCs: 0% roll at maturity
 - Buybacks: \$1 billion per month
 - Deposits at US banking affiliates: 80% roll at maturity
 - In practice, no impact on liquidity (operate with significant excess liquidity)
 - Ability to draw on committed facilities
- ◆ **Loan funding**
 - Per funding schedule for leveraged loans
 - Some loan commitments drawn outside of the bank entities
- ◆ **Derivatives**
 - Cash collateralization on derivative payables per CSA requested on day 1 (paid on day 2 per industry practice)
 - Margin disputes against us paid on day 3 and 4
 - 2 notch downgrade during second week
 - Note: The vast majority of the credit rating downgrade-related posting requirements come from derivative transactions with structured vehicles, which have a 30 day cure period, which gives us to assign or restructure the transactions, thereby avoiding the posting of additional collateral.
- ◆ **Other**
 - \$0.5 billion every other week to cover operational cash expenses (PE and NPE)
 - No sale of assets or reduction in customer financing

Stress Scenario Assumptions Vs. Week Of March 17

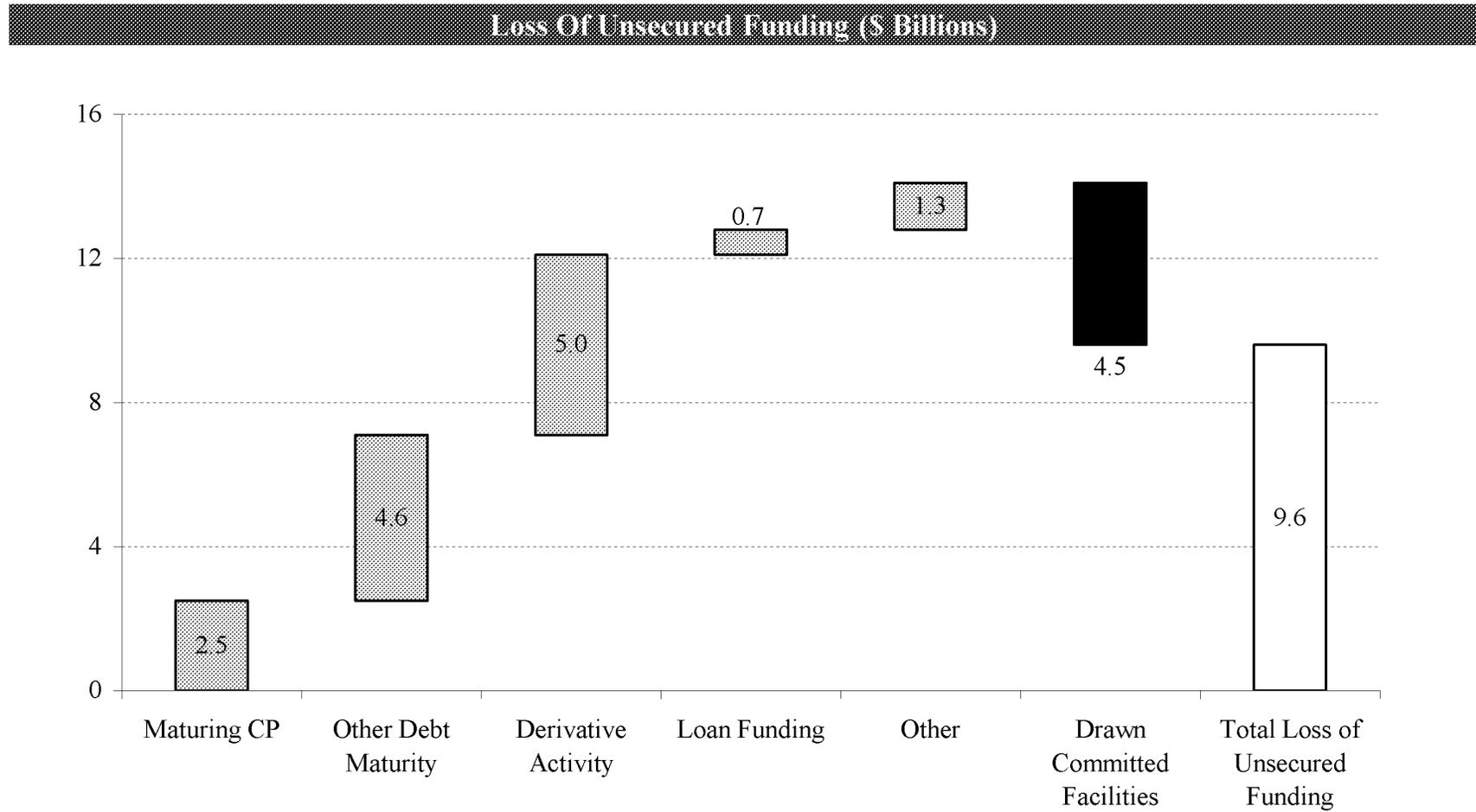
Stressed Liquidity Scenario

Assumptions	% Repo Funding Lost	
	Experienced During Week of 3/17	Stress Scenario
◆ The assumptions used in our liquidity stress scenarios are far more severe than what we experienced during the week of March 17.		
◆ We have refined our assumptions and made them more conservative:		
– 100% of repos funding less liquid collateral (high yield, non major index equities) do not roll		
	Secured Funding	
	Governments & Agencies	0%
	Corporates	
	High Grade	0%
	High Yield	13%
	Asset Backs / Private Labels	
	High Grade	7%
	High Yield	0%
	Commercial Paper Repo	10%
	Munis	0%
	Munis TOB Program	0%
	Equities / Converts	
	Major Index (E1)	
	Other Index (E2 / C1)	14%
	Non Major Index (E3 / C2)	3%
	Collateral Upgrade (E1)	3%
	Prime Broker Free Credit Balances	30%
	Unsecured Funding	
	LEH Commercial Paper	29%
	LTD Buybacks (\$Billions)	0.11
	Derivatives	
	Cash Collateralization per CSA	~25%

Loss of Unsecured Funding

Stressed Liquidity Scenario

◆ Stress scenario results in a loss of \$9.6 billion of unsecured funding over a period of one month.

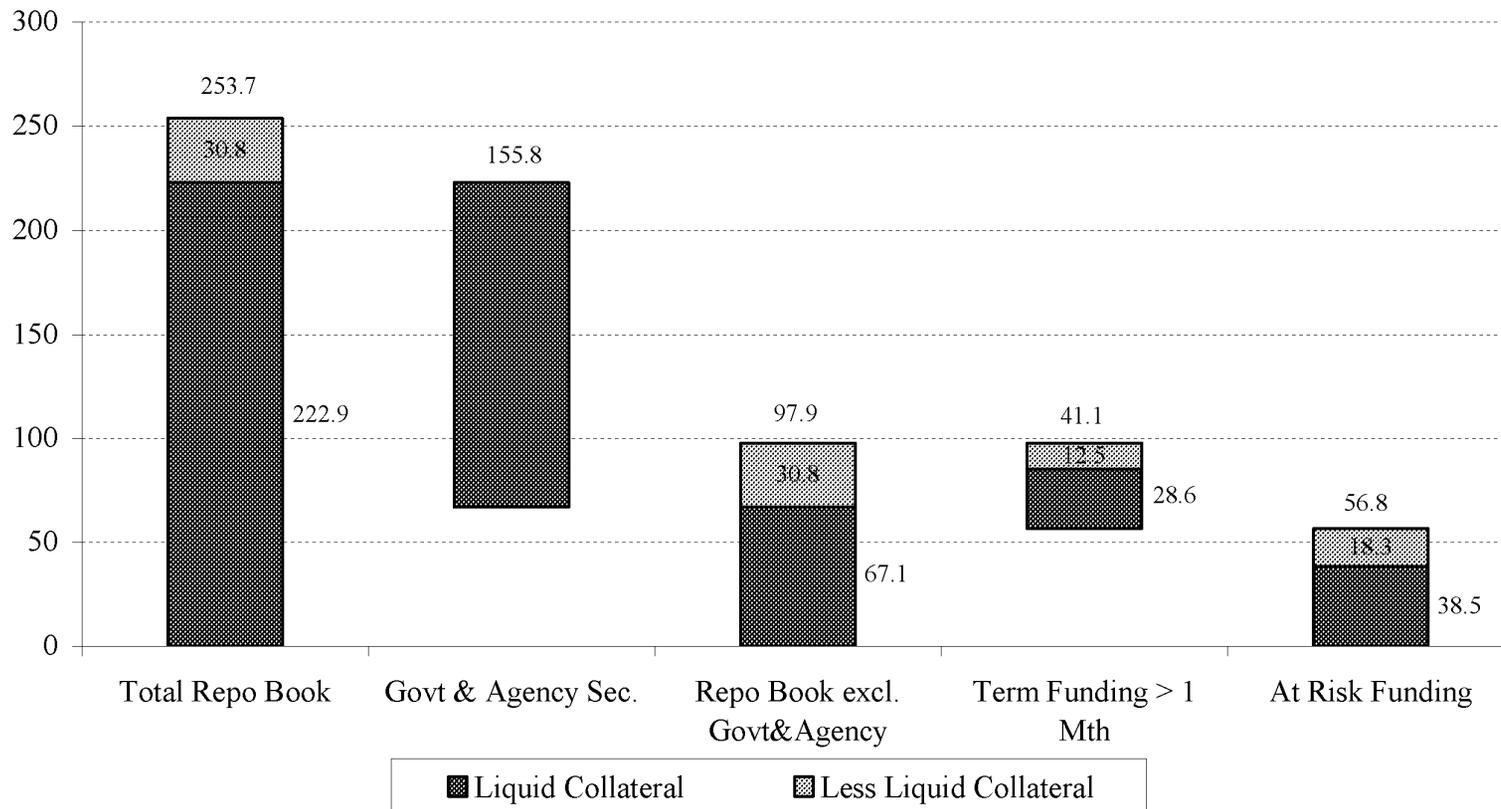


Repo Book Analysis

Stressed Liquidity Scenario

- ◆ As of July 30, our tri-party repo book amounted to \$254 billion - \$156 billion of Government and Agency securities; \$67 billion of liquid collateral (investment-grade fixed income securities and major index equities); \$31 billion of less liquid collateral (high yield fixed income securities and non major index equities). The amount of repo funding “at risk” (i.e., maturing within a month) was \$57 billion - \$39 billion in liquid collateral and \$18 billion in less liquid collateral.

Composition Of Lehman's Tri-Party Repo Book As of 30 July (\$ Billions)

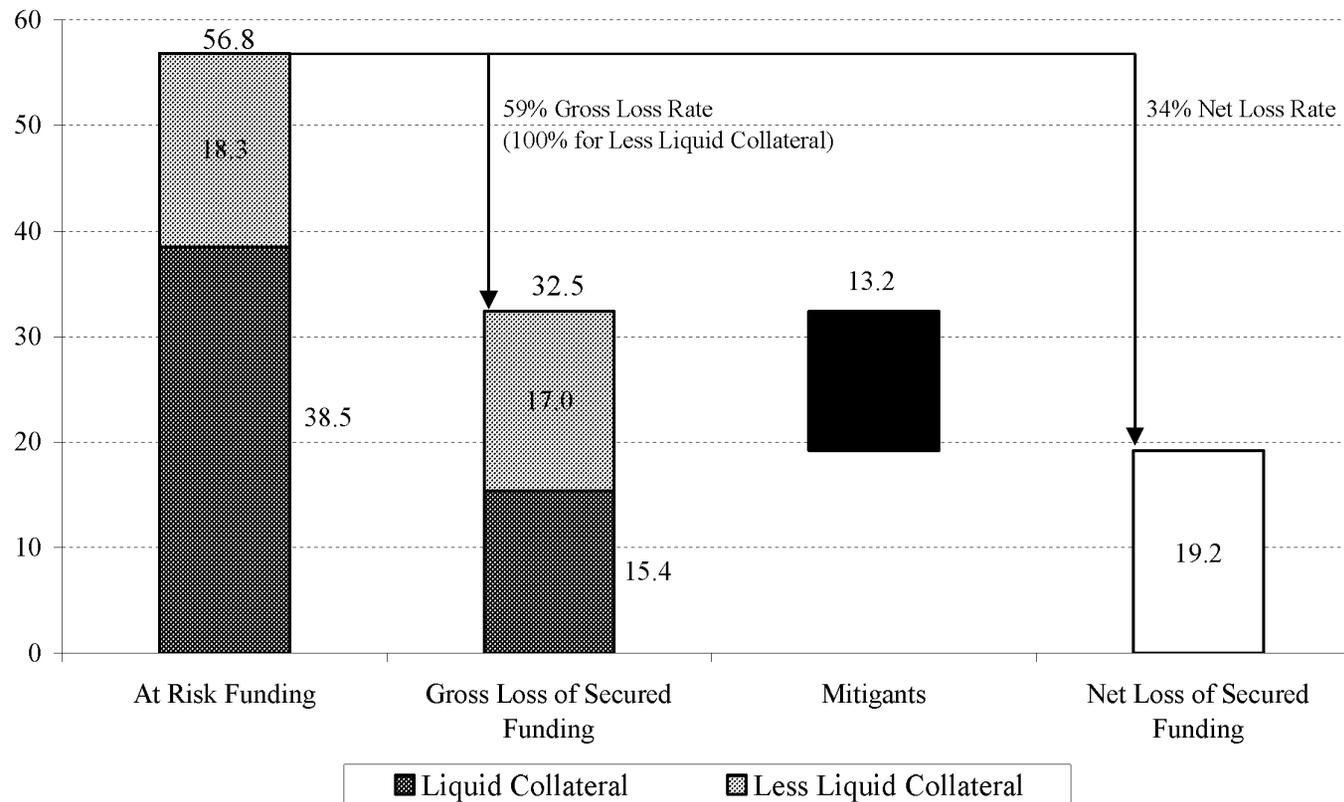


Loss Of Secured Funding

Stressed Liquidity Scenario

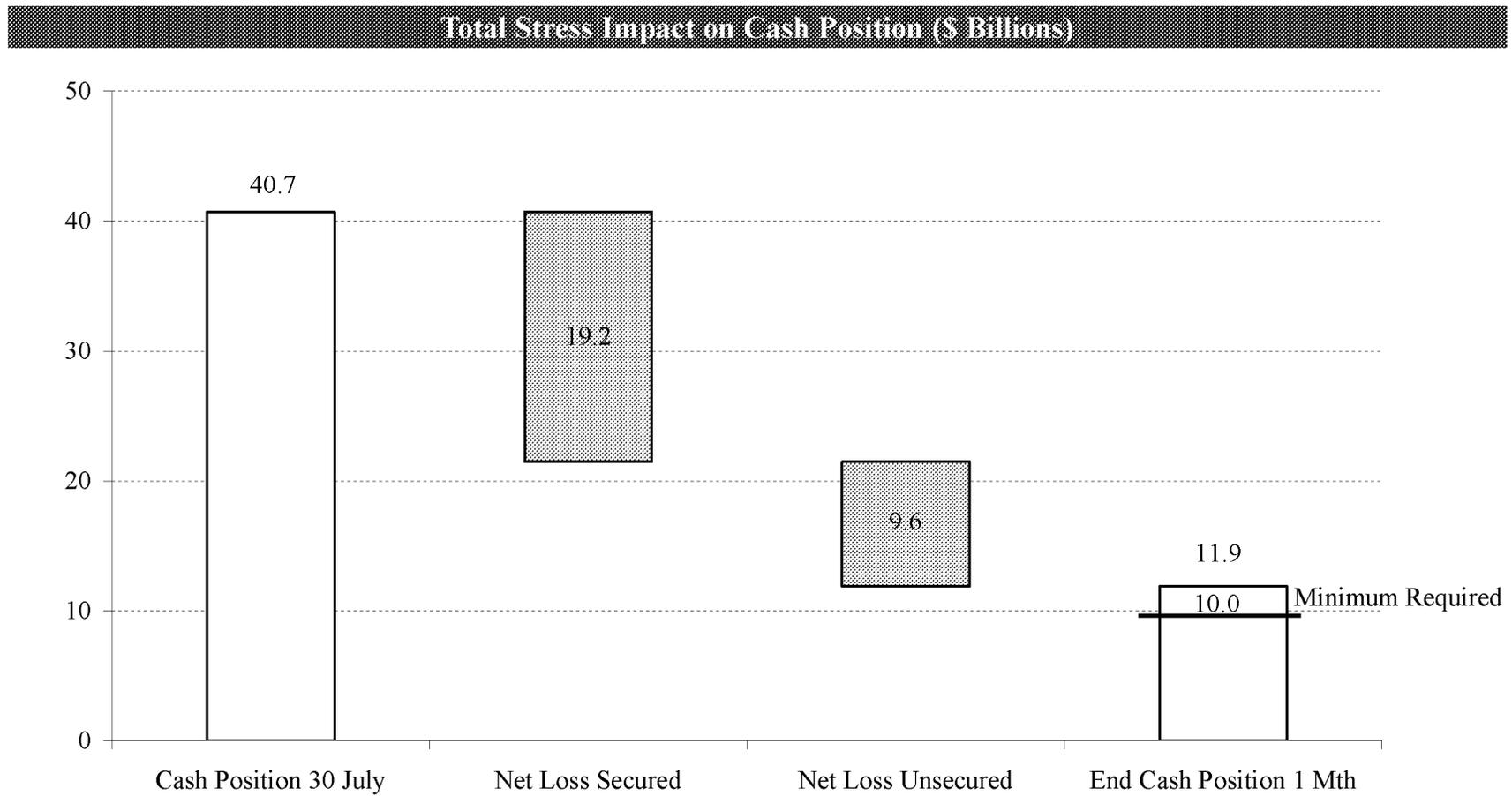
- ◆ Stress scenarios result in a \$32 billion gross loss of secured funding over one month (i.e., 59% of secured funding being lost, 100% for the less liquid collateral). Including “mitigants” (e.g., \$9 billion due to overfunding, excess collateral borrowed, \$3 billion due to pledging eligible assets to the ECB and \$1 billion due to the unwind of our proprietary matched book), the net loss of secured funding amounts to \$18 billion.

Loss Of Secured Funding (\$ Billions)



Stress Scenario Result

- ◆ Overall stress scenario result in loss of funding of \$27.8 billion, mitigated by a starting cash position of \$40.7 billion. The cash position after one month of stress of \$12.9 billion is above our aim of \$10 billion.



Stress Liquidity Scenario: Overall Impact

Stressed Liquidity Scenario

	31-Jul	01-Aug	04-Aug	05-Aug	06-Aug	07-Aug	08-Aug	11-Aug	12-Aug	13-Aug	Week 3	Week 4	Total
Beginning Cash Position	40.7	26.7	26.3	27.2	26.4	25.5	22.6	22.2	21.8	19.9	19.9	18.3	40.7
Net Loss Secured Funding	(11.9)	1.5	0.0	(0.4)	(0.2)	(1.9)	(0.2)	0.0	(0.9)	0.0	0.2	(5.4)	(19.2)
Unsecured Funding													
Unsecured Debt													
CP	(1.7)	(0.4)	(0.1)		(0.1)			(0.1)			(0.1)		(2.5)
STD excluding CP			(0.1)								(1.2)		(1.3)
LTD			(0.2)	(0.1)	(0.1)	(1.0)					(0.1)	(0.8)	(2.3)
Buybacks				(0.2)			(0.2)				(0.4)	(0.2)	(1.0)
Deposits of Banking Affiliates	(0.4)												(0.4)
Committed Facility Drawdown			4.5										4.5
Net Loan Funding		0.4	(0.9)	0.3					(1.0)		0.5		(0.7)
Derivative Activity													
Posting of Uncalled Collateral		(1.9)	(1.9)										(3.8)
Downgrade (2 Notches)								(0.3)					(0.3)
Disputed Margin Payments			(0.4)	(0.4)									(0.8)
Cash outflows to fund operations (PE, NPE, etc.)					(0.5)						(0.5)		(1.0)
Total Net Loss Unsecured Funding	(2.1)	(1.9)	0.9	(0.4)	(0.7)	(1.0)	(0.2)	(0.4)	(1.0)	0.0	(1.8)	(1.0)	(9.6)
Ending Cash Position	26.7	26.3	27.2	26.4	25.5	22.6	22.2	21.8	19.9	19.9	18.3	11.9	11.9

Details next slide

1. Net loss of secured funding also includes the positive impact of the reduction in the funding of prime broker clients and of balance sheet reduction

LEHMAN BROTHERS

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Stress Liquidity Scenario: Loss Of Secured Funding

Stressed Liquidity Scenario

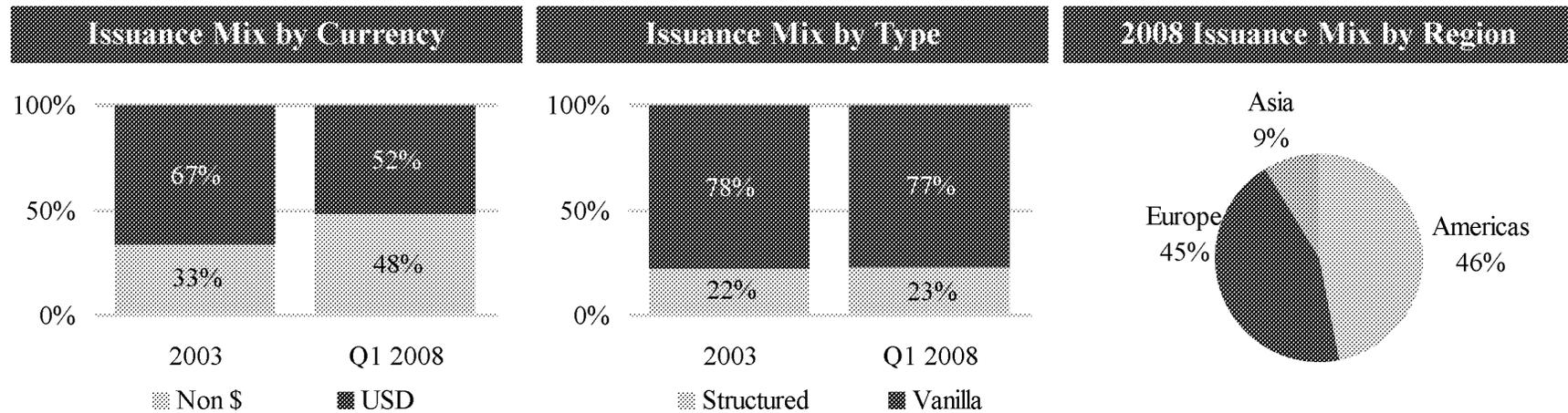
Secured Funding	Total Repo Book	Total At Risk	31-Jul 1-Aug 4-Aug 5-Aug 6-Aug 7-Aug 8-Aug 11-Aug 12-Aug 13-Aug Week 3 Week 4 Total													
			31-Jul	1-Aug	4-Aug	5-Aug	6-Aug	7-Aug	8-Aug	11-Aug	12-Aug	13-Aug	Week 3	Week 4	Total	
Lost Capacity																
LBJ																
E1 - Major Index Equities	0.1	0.0	-	-	-	-	-	-	-	-	-	-	-	-	0.0	0.0
E2 - Non-Major Index Equities	1.1	0.0	-	-	-	-	-	-	-	-	-	-	-	-	0.0	0.0
E3 - Non-Major Index Equities (<\$5)	0.2	0.2	-	-	-	-	-	-	-	-	-	-	-	-	0.2	0.2
EMG	0.0	0.0	-	-	-	-	-	-	-	-	-	-	-	-	0.0	0.0
Total LBJ	1.5	0.3	-	-	-	-	-	-	-	-	-	-	-	-	0.3	0.3
LBIE																
Government Agency	0.1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sovereigns	11.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Asset Backs - Investment Grade	17.0	0.9	0.1	0.0	-	-	0.3	0.0	-	0.0	-	-	-	0.0	0.1	0.5
Asset Backs - Non-Investment Grade	0.1	0.0	0.0	0.0	-	-	0.0	-	-	-	-	-	-	-	-	0.0
C1 - Investment Grade Convertibles	0.5	0.2	0.0	0.0	0.0	0.0	-	-	0.0	0.1	-	-	-	0.0	0.0	0.2
C2 - Non-Investment Grade Convertibles	1.2	0.7	0.1	0.1	0.0	0.0	-	-	0.0	0.3	-	-	-	0.1	0.2	0.7
Corporates - Investment Grade	7.3	5.5	0.5	0.3	0.3	0.0	0.0	0.0	0.0	0.1	-	-	-	0.3	0.1	1.6
Corporates - Non-Investment Grade	1.8	1.0	0.6	0.1	0.0	-	0.1	0.0	0.1	0.1	-	-	-	0.1	0.1	1.0
E1 - Major Index Equities	5.7	2.6	0.0	0.1	0.2	0.1	0.0	0.0	0.1	0.1	-	-	-	0.1	0.1	0.8
E2 - Non-Major Index Equities	3.4	1.4	0.2	0.2	0.0	0.2	0.0	0.1	0.2	0.2	-	-	-	0.2	0.1	1.4
E3 - Non-Major Index Equities (<\$5)	4.2	2.2	0.2	0.3	0.2	0.0	0.1	0.1	0.0	0.5	-	0.2	-	0.5	0.1	2.2
EMG	4.5	2.1	0.7	0.2	0.4	0.1	0.1	0.0	0.1	0.1	-	-	-	0.2	0.3	2.1
Money Markets	0.1	0.0	-	-	0.0	-	-	-	-	-	-	-	-	0.0	-	0.0
Private Labels - High Yield	0.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Private Labels - Investment Grade	0.0	0.0	0.0	-	-	-	-	-	-	-	-	-	-	-	0.0	0.0
Total LBIE	57.0	16.5	2.3	1.2	1.0	0.5	0.7	0.3	0.5	1.5	-	0.2	1.4	0.9	10.5	
LBI																
Government Agency	32.8	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
MBS	66.6	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sovereigns	45.3	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Asset Backs - Investment Grade	4.5	3.1	0.9	-	-	0.0	-	-	0.0	-	0.2	-	0.2	0.5	1.9	
Asset Backs - Non-Investment Grade	1.6	0.9	0.2	-	-	-	-	-	-	0.6	-	0.1	-	-	0.9	
C1 - Investment Grade Convertibles	0.0	0.0	0.0	-	-	-	-	-	-	-	-	-	-	-	0.0	
C2 - Non-Investment Grade Convertibles	0.1	0.1	0.1	-	-	-	-	-	-	-	-	-	-	-	0.1	
Corporates - Investment Grade	8.7	7.6	2.3	-	-	-	-	-	-	-	0.0	-	0.0	-	2.3	
Corporates - Non-Investment Grade	4.0	3.8	3.6	0.1	-	-	-	-	0.1	-	0.0	-	-	-	3.8	
E1 - Major Index Equities	4.8	3.6	1.1	-	-	-	-	-	-	-	-	-	-	-	1.1	
E2 - Non-Major Index Equities	4.6	2.0	1.5	0.5	-	-	-	-	-	-	-	-	-	-	2.0	
E3 - Non-Major Index Equities (<\$5)	0.5	0.4	0.4	-	-	-	-	-	-	-	-	-	-	-	0.4	
Money Markets	8.0	7.0	2.1	-	-	-	-	-	-	-	-	-	-	-	2.1	
Muni	3.5	3.5	2.0	-	0.1	-	-	-	-	-	-	-	-	-	2.1	
Private Labels - High Yield	1.8	0.5	0.5	-	0.0	-	-	-	-	-	0.0	-	0.0	0.0	0.5	
Private Labels - Investment Grade	7.9	7.3	1.9	-	0.0	-	-	-	-	-	-	-	-	2.5	4.4	
Total LBI	194.7	40.0	16.6	0.6	0.1	0.0	-	-	0.1	-	0.9	-	0.3	3.1	21.7	
LBHI																
Wholeloan Residential	0.5	0.1	0.1	-	-	-	-	-	-	-	-	-	-	-	0.1	
Total Lost Capacity	253.7	56.8	19.0	1.8	1.1	0.5	0.7	0.3	0.6	1.5	0.9	0.2	1.7	4.3	32.5	
Mitigants and other stress elements																
LBIE																
Prime Broker Customer Free Credits			(0.9)	-	-	-	-	-	-	-	-	-	-	-	-	(0.9)
Prime Broker Reduction			-	-	-	-	-	-	-	-	-	-	-	-	-	-
Excess Collateral Returned			1.4	0.6	0.5	0.1	0.5	0.2	0.4	1.3	-	0.2	0.8	0.3	6.2	
ECB			0.8	0.3	0.3	-	-	0.0	-	0.1	-	-	0.1	0.1	1.8	
Bankhaus Funding ECB Eligible			1.7	-	-	-	-	-	-	-	-	-	-	-	1.7	
Total LBIE			3.0	0.9	0.8	0.1	0.5	0.2	0.4	1.4	-	0.2	0.9	0.3	8.8	
LBI																
Prime Broker Customer Free Credits			(2.5)	2.5	-	-	-	-	-	-	-	-	-	-	-	
Unwinding of Muni TOB Prog. (\$3.5 billion gross)			-	-	-	-	-	(1.8)	-	-	-	-	1.8	-	-	
Balance Sheet Reduction			-	-	-	-	-	-	-	-	-	-	-	-	-	
Writedowns on balance sheet reduction			-	-	-	-	-	-	-	-	-	-	-	-	-	
Dealer-based Matched Book Reduction			-	-	1.0	-	-	-	-	-	-	-	-	-	1.0	
Excess Collateral Returned			2.7	-	-	-	-	-	-	-	-	-	-	-	2.7	
Term Overfunding			3.9	(0.2)	(0.7)	-	-	-	-	-	-	-	(0.7)	(1.5)	0.8	
Total LBI			10.7	2.1	(0.4)	-	-	(1.8)	-	-	-	-	1.1	(1.5)	4.5	
Net Loss Secured Funding			(11.9)	1.5	(0.0)	(0.4)	(0.2)	(1.9)	(0.2)	(0.0)	(0.9)	-	0.2	(5.4)	(19.2)	

Additional Liquidity Considerations

Funding Diversification

Diversify issuances by currency, type and region to broaden debt investor base

- ◆ Currency sources - currency base is diversified, ~ 48% of long-term debt issued in currencies other than USD
- ◆ Funding instruments - in addition to plain vanilla debt, diversify funding base by issuing structured notes
- ◆ Investor base - diversify issuances geographically with ~ 53% of long-term debt portfolio issued in Europe and Asia



Recent Benchmark Issuances

Issued \$9.5 billion in four benchmark issuances since the start of the second quarter

- ◆ \$4.0 billion of non-cumulative perpetual convertible preferred stock
 - Dividend of 7.25% per annum
 - More than three times oversubscribed
- ◆ \$2.0 billion 30-year subordinated debt
 - Treasuries + 305 bps
 - \$4.0 billion of orders within 1 hour
- ◆ \$2.5 billion of 10-year senior debt
 - Treasuries + 320 bps
 - \$6.5 billion of orders within 1 hour
- ◆ £0.5 billion (\$1.0 billion) 10-year senior debt
 - Gilts + 315 bps
 - £0.8 billion of orders within 4 hours

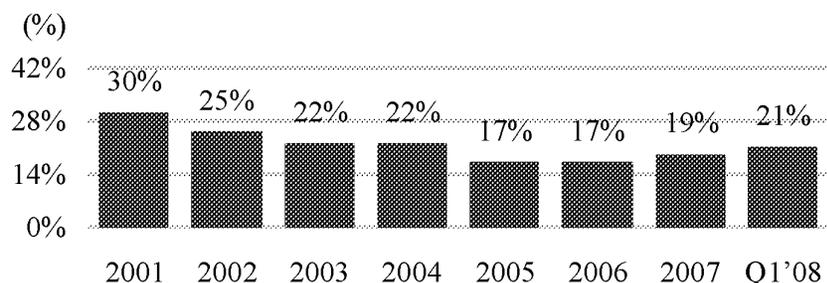
- ◆ Completed debt issuance program for the rest of the year
 - May issue further during the latter part of the year to “pre fund” 2009 debt issuance requirements

Managing Rollover Risk

Limit rollover risk by distributing debt maturities

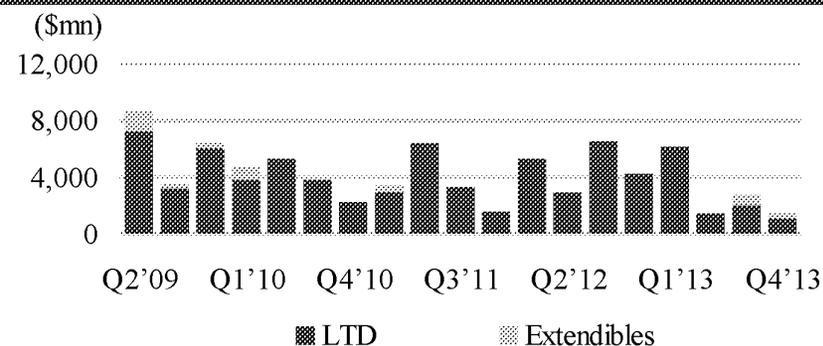
- ◆ Reduce the impact of a liquidity event by not relying on short-term debt
- ◆ Instead, increase the share of debt that is long-term while ensuring that the percentage of maturing long-term debt is no more than 12.5%, 17.5% and 30.0% of outstanding long-term debt borrowings over any 3-month, 6-month and 12-month horizon, respectively

Short Term Debt to Total Debt



(\$bn)	2001	2002	2003	2004	2005	2006	2007	Q1'08
St Debt ⁽²⁾	12.5	10.3	9.9	9.9	11.4	20.6	28.1	34.5
Total Debt	42.3	41.1	45.9	59.3	65.3	101.8	151.2	162.8

Maturing Long-Term Debt⁽¹⁾



Months	Limits	Actual	Period
3	12.5%	7%	3/01/09 – 5/31/09
6	17.5%	10%	11/01/09 - 4/30/10
12	30.0%	18%	5/01/12 - 4/30/13

1. \$5.05 billion of extendibles are shown at their earliest maturity dates. Extendibles are long-term debt, the earliest maturity date of which is automatically extended unless debt holders instruct us to redeem their debt. Because the redemption notification must occur at least one year prior to the earliest maturity date, extendibles are included in long-term debt. Moreover, because the earliest maturity date generally is extended, extendibles "roll" through the long-term debt profile.

2. Short term debt includes current portion of long term debt.

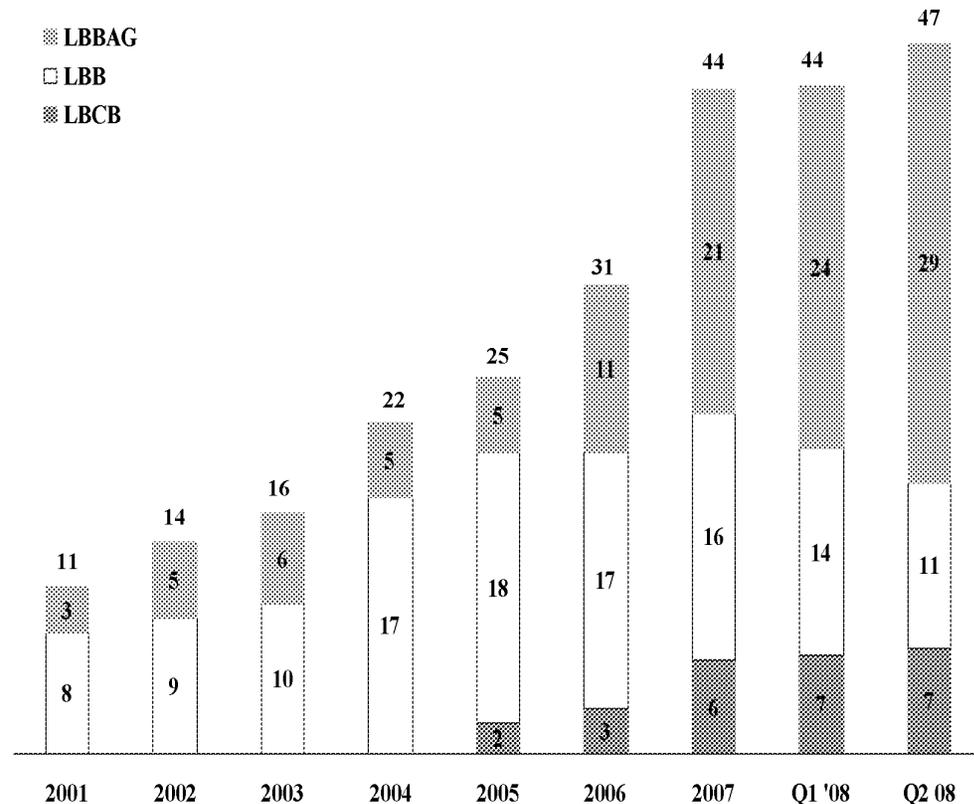
Bank Entity Asset Growth and Asset Funding

Strong asset growth at bank entities provides a reliable funding source. The three banking entities all benefit from raising cost-effective financing in a depositor-protected environment

Banking Entities

- ◆ **Lehman Brothers Bank (LBB) :** Funds all US residential mortgage origination. Additionally funds commercial mortgages and investment grade US loans. Can access the Fed discount window
- ◆ **Lehman Brothers Commercial Bank (LBCB) :** Funds commercial mortgages, derivative receivables and corporate & industrial loans. Can access the Fed discount window
- ◆ **Lehman Brothers Bankhaus (LBBAG) :** Funds securities on repo and loans (commercial, residential and corporate). Can access the ECB discount window

Banking Entities – Total Assets (\$Billions)

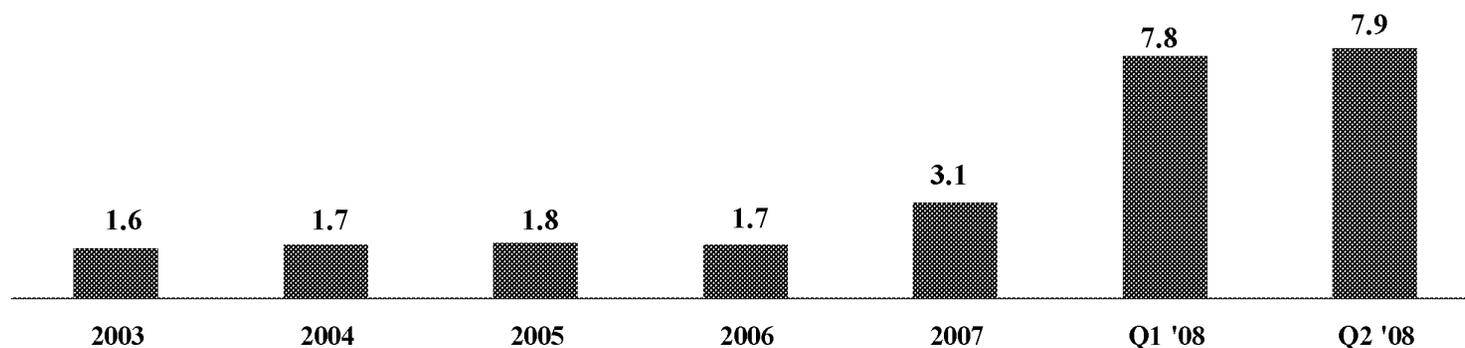


Commercial Paper

Strategic use of commercial paper rather than as a funding source for core requirements

- ◆ Use term commercial paper to mitigate short-term liquidity outflows such as unforeseen operational friction (fails), a sudden drop in prime broker lock-ups or sudden changes in secured funding
 - Do not use commercial paper to fund core requirements or illiquid assets because it is not a good source of cash capital
- ◆ Issue overnight commercial paper for two reasons
 - As a way to introduce new investors to Lehman Brothers' commercial paper in the hope that they will buy term CP over time – as evidenced by the growth in our term CP program in April and May
 - To measure sentiment toward Lehman Brothers: CP investors tend to be lead indicators of improving markets
- ◆ Conservatively do not attribute any liquidity value to overnight CP program even though there is still a market, albeit a small one, in most market environments

Commercial Paper Outstanding (\$ Billions)



Rating Agency Comments on Lehman Liquidity

Additional Liquidity Considerations

The rating agencies have recently commented favorably on the Firm's liquidity and have also been supportive of recent Fed action to provide additional solutions to an industry-wide structural liquidity issue

- ◆ “...its excess liquidity position (\$34 billion at Feb. 29, 2008) is among the largest proportionately of the U.S. broker-dealers, and its sources-to-uses ratio is the strongest of the five.”
- S&P, Research Update; March 21, 2008

- ◆ “Lehman has consistently been among the top financial institutions in managing risk, including market, credit, and liquidity risks.”
- ◆ “...Lehman's liquidity management and position remain robust and are underpinned by a funding framework that is scaled to the firm's expectations for, and vetting of, reliable secured funding...”
- Moody's, Research Update; March 17, 2008

- ◆ “Liquidity remains strong with Lehman's lower reliance on short-term funding relative to its peers...”
- ◆ “...Lehman has managed its liquidity well in the last eight months.”
- Fitch, Research Update; April 1, 2008

- ◆ “Lehman's liquidity position is robust...”
- DBRS, Research Update; March 19, 2008

Capital Planning

Ownership – Global Capital Management

Global Capital Management

- ◆ The level of capital maintained by the Lehman Group is reviewed and managed by the Global Financial Planning & Analysis team, which is a part of the Finance function. Global equity adequacy models maintained by Treasury incorporate the strategic planned growth of the Firm, the impact on key risk areas (including liquidity risk) of stressed environments, the ability to source capital, and requirements specific to regional and regulated entities within the group. The overall adequacy of capital held is determined taking account of Economic Capital and Regulatory Capital requirements.
- ◆ Risk limits for the Lehman Group are determined through the Risk Appetite process. The key decision which constrains risk limits is that, at a 95% confidence level, the Firm is expected to generate at least a minimum acceptable ROTE under stressed market conditions. Minimum capital requirements, as determined by Treasury, feed this calculation.
- ◆ Economic Capital requirements are determined through the Risk Equity process. The return on Economic Capital is a key measure used in the assessment of business performance.
- ◆ Global Regulatory Capital requirements are determined by the Regulatory Control group; a part of the Finance function.

Ownership cont..

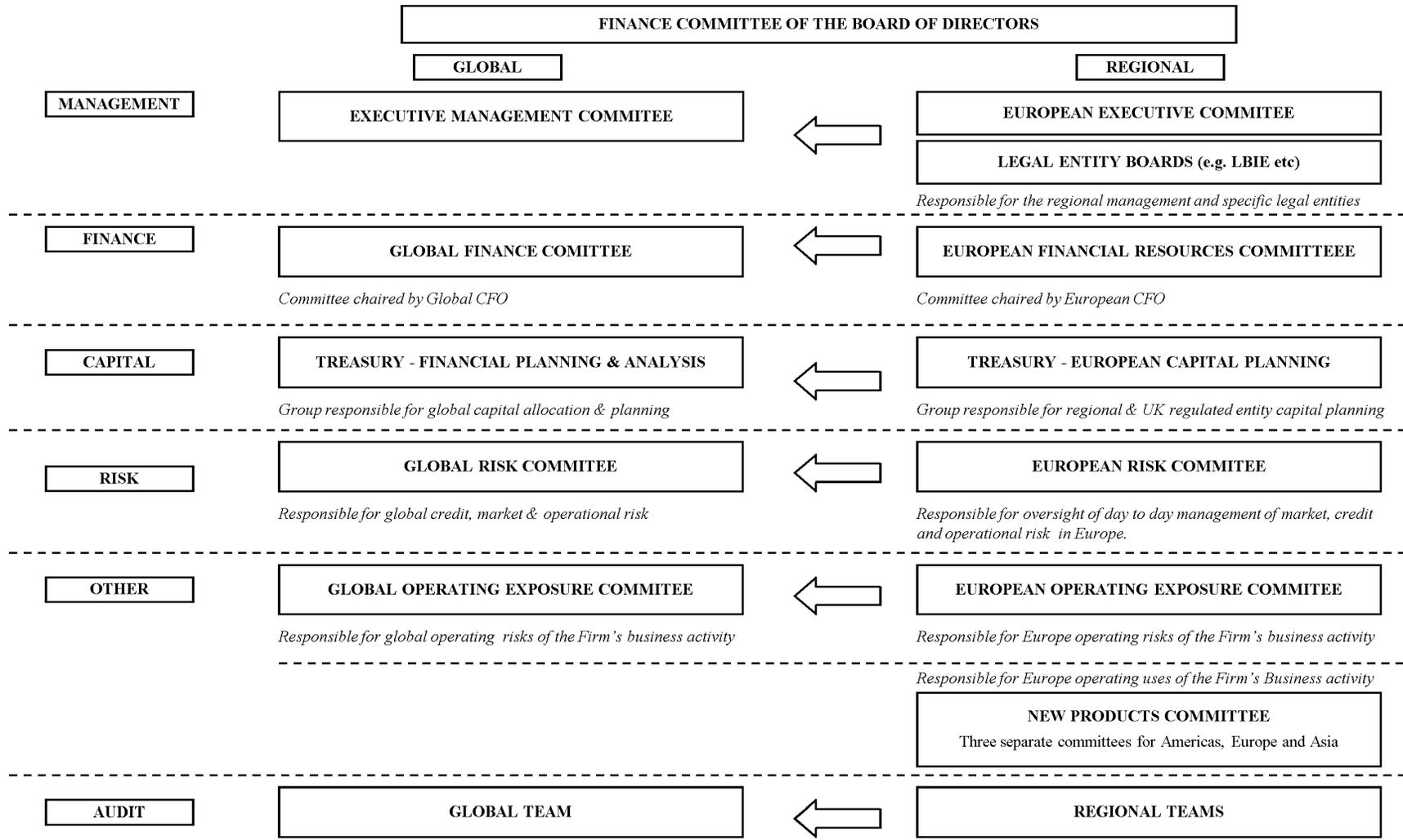
Regional Capital Management

- ◆ The European Capital Planning team is responsible for ensuring that adequate capital is held within the region's regulated entities. Consideration is given regionally to measuring internal capital requirements, regulatory capital requirements, and the impact of stressed market environments. However, the requirement for Regulatory Capital inevitably exceeds internal capital requirements, and is therefore the primary driver for regional capital planning. Regional requirements form an input to the global capital management process.

- ◆ Regional Regulatory Capital requirements are determined by the European Regulatory Control group, which is a part of the Finance function.

Corporate Governance

The diagram below illustrates the governance with regards to capital planning, from dedicated groups within the Treasury department, to governing committees of Lehman Brothers.



Corporate Governance cont..

Structure

- ◆ Global - Lehman Brothers global capital adequacy is overseen by the Financial Planning & Analysis team, within the Treasury function. The Global Treasurer attends the Global Finance Committee on a weekly basis, at which decisions concerning the capital position of the group are addressed. The Global Finance Committee is chaired by the Global CFO, who also reports to the Finance Committee of the Board of Directors.

- ◆ Regional – Capital planning for the Lehman Brothers UK consolidated group is overseen by the European Capital Planning team, within the Treasury function. The Capital Planning team provides information to both regional management and the global planning team. The International Treasurer sits on the European Financial Resources Committee, at which regional management of capital is addressed. The EFRC is chaired by the European CFO. The European CFO attends the Global Finance Committee.

- ◆ The European CFO sits on the European Risk Committee.

- ◆ Regional Regulatory Capital requirements are determined by the European Regulatory Control group, which is a part of the Finance function.

Capital Planning and Risk

The linkage between the assessment of risk and the assessment of the amount of capital that should be held to support that risk is of fundamental importance to Lehman Brothers

- ◆ The Firm has for many years managed its business, at all levels, through the twin measures of Risk Appetite and Risk Equity (incorporating economic capital). These measures drive risk limits for market and counterparty credit risk, and provide the basis for planning and performance measurement, and accordingly are totally embedded in the manner in which the business of the Lehman Group is managed.

- ◆ The major risk exposures which the Firm believes should be supported by capital in the UK consolidated group arise from market risk, counterparty credit risk and operational risk; these risks are factored into the Firm's Risk Equity model.

ICAAP Capital

Lehman Brothers carries out an internal assessment of capital required to support its UK Regulated entities, in line with Pillar 2 requirements.

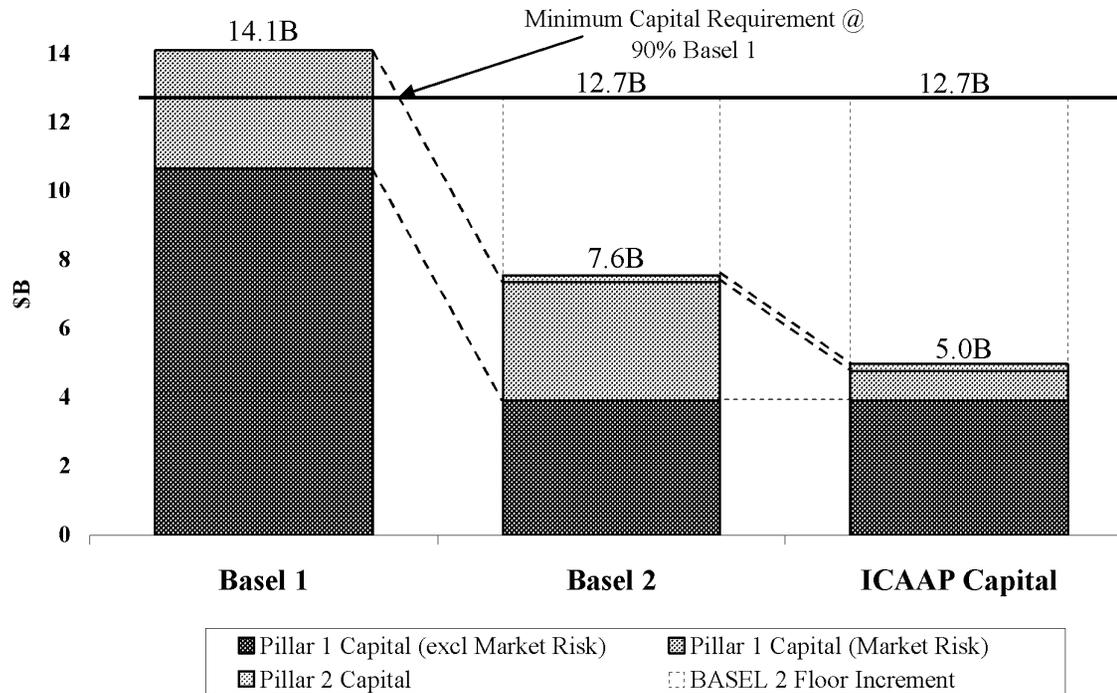
- ◆ The Firm has defined its ICAAP Capital in a manner which is consistent with Risk Equity to the extent possible :
 - for market risk and counterparty credit risk, ICAAP Capital utilises the primary risk factors that impact on Risk Equity, except that ICAAP Capital adopts the standardised mark-to-market regulatory capital calculations for counterparty credit exposure risk and IRB ratings for equity derivatives;
 - for operational risk, ICAAP Capital adopts the Basic Indicator approach, which is broadly consistent with the approach currently utilised for Risk Equity; during 2008, both ICAAP Capital and Risk Equity are expected to adopt AMA for operational risk; and
 - capital is added, as required, to support ‘Pillar 2 risks’.

- ◆ As the Firm must at all times hold capital at least equal to the level of the Basel 2 capital resources requirement, and also to the level of 90% of the Basel 1 capital resources requirement (for 2008 reducing to 80% for 2009), the Minimum Capital Requirement is currently defined to be the highest of ICAAP Capital, the Basel 2 requirement and 90% of the Basel 1 requirement.

- ◆ When the FSA provides Individual Capital Guidance (ICG) this will take the place of Basel 2 in the above comparison.

ICAAP Capital cont...

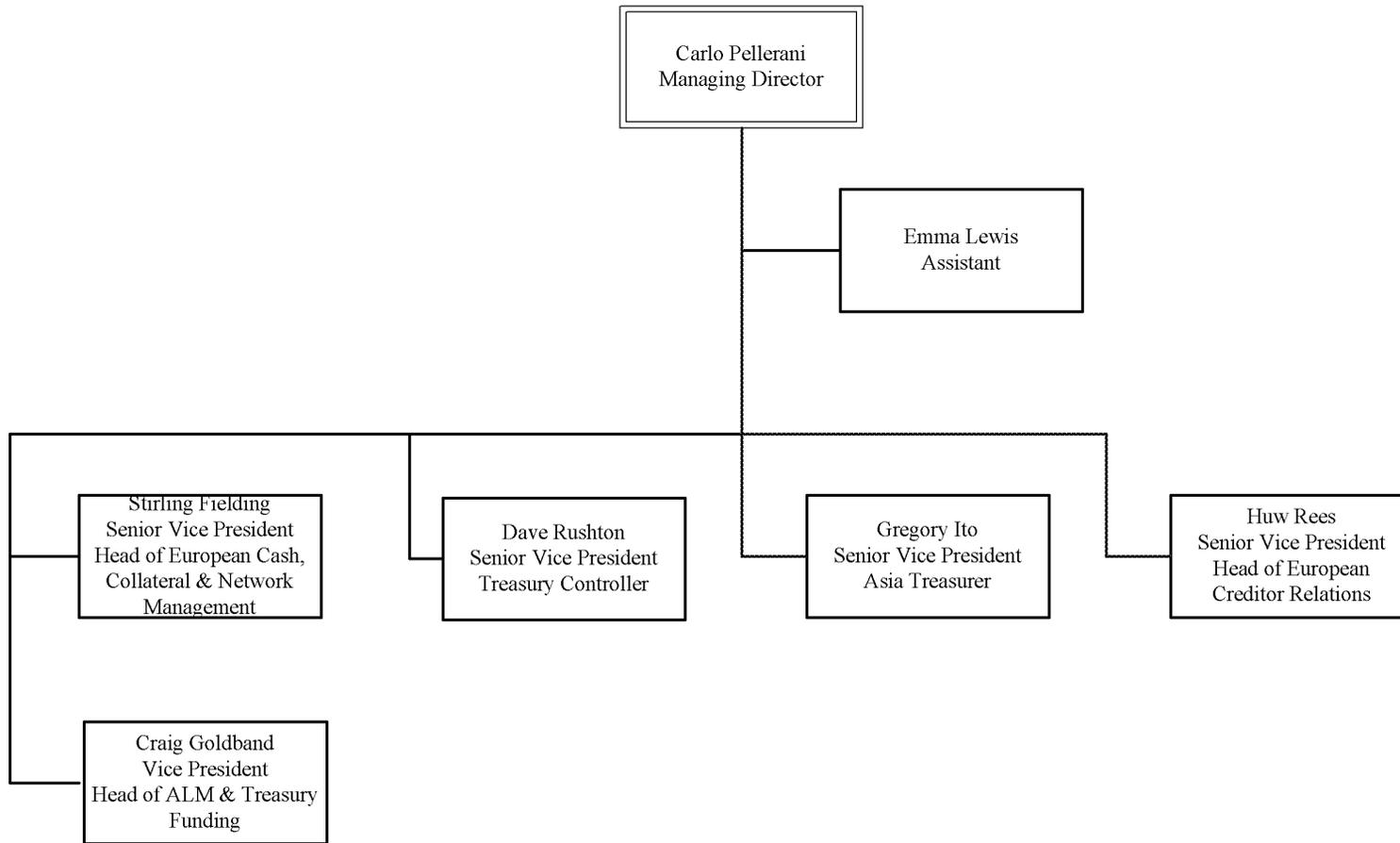
Comparison of Basel 1 and Basel 2 Capital Requirements as at 30 May 2008



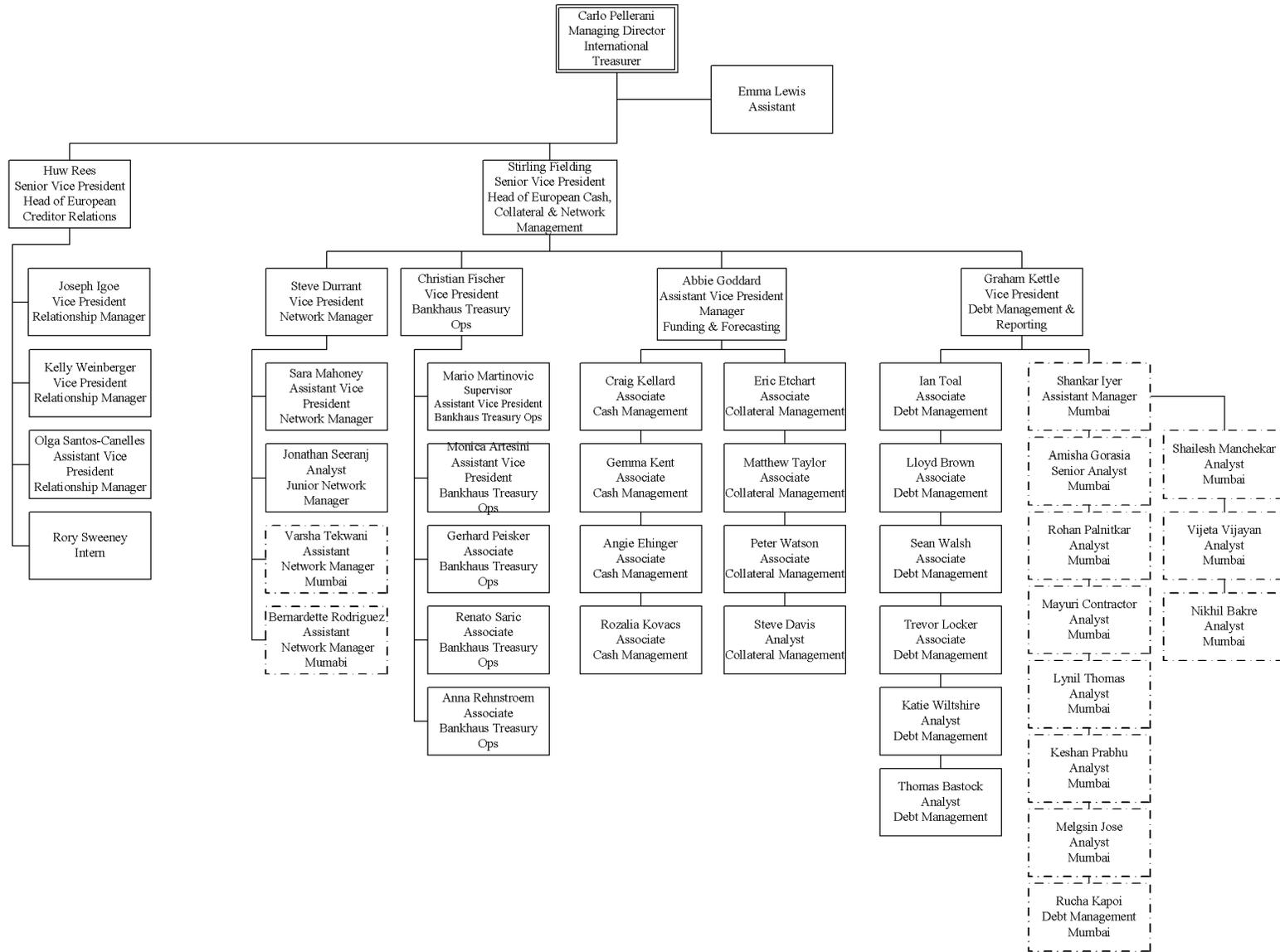
	Basel 1	Basel 2	ICAAP	Reason for Variance
Pillar 1 Risk - Market Risk	3,431	3,431	842	Move from CAD1/standardised measurement to CAD2
Pillar 1 Risk - Other excl. Market Risk	10,671	3,928	3,928	Basel 2 & ICAAP include impact of IMM/FIRB waiver
Pillar 2 Risk	0	200	200	Basel 2 & ICAAP include Pillar 2 requirement for Pension Risk
Capital Requirement (excl. Floor)	14,102	7,559	4,970	
Floor Increment	N/A	5,133	7,722	
Capital Requirement (incl. Floor)	14,102	12,692	12,692	Minimum capital requirement for Lehman Brothers is floored at 10% reduction on Basel 1 requirements

Appendices

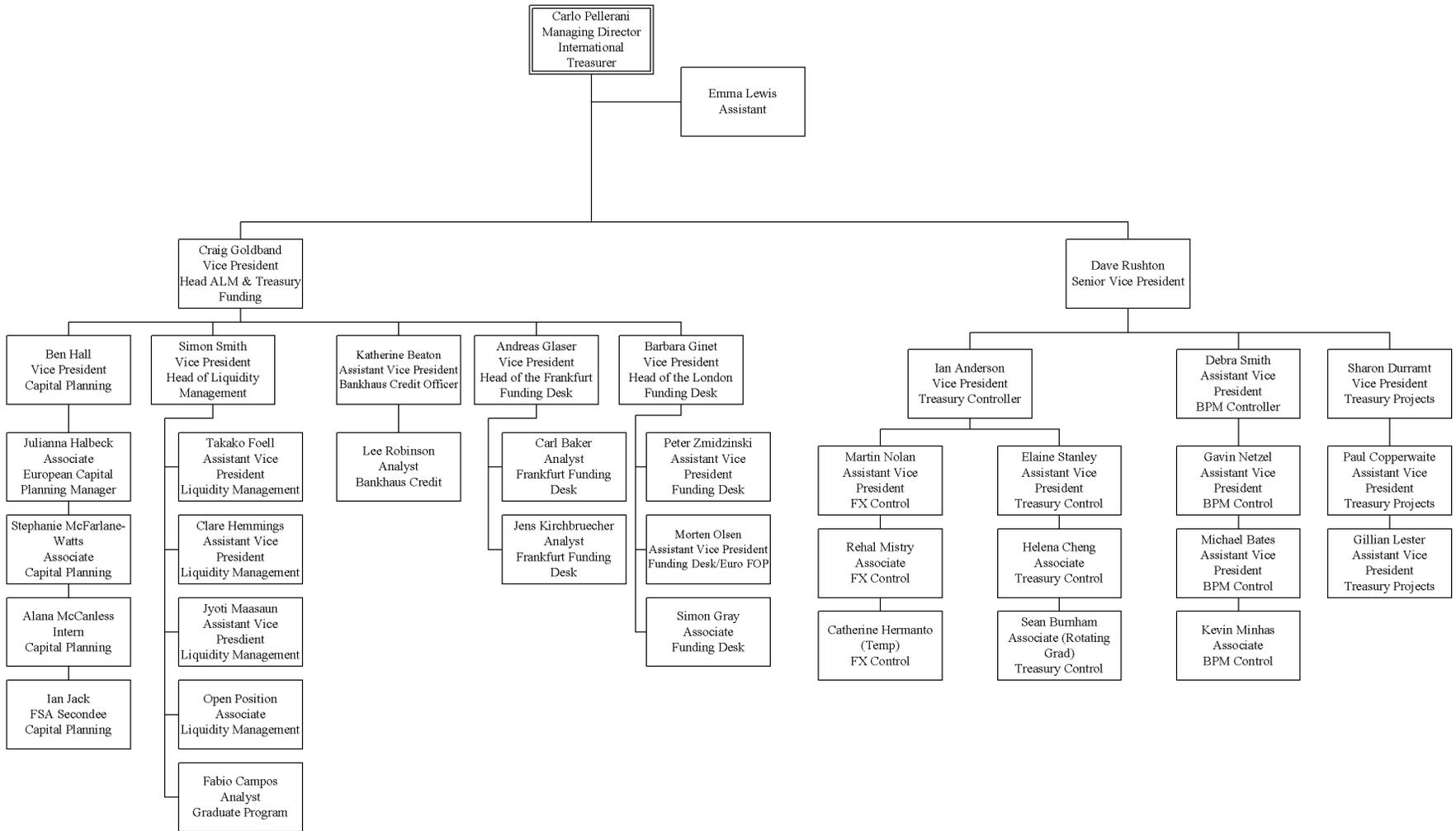
International Treasury - 1



International Treasury - 2



International Treasury - 3



International Treasury - 4

