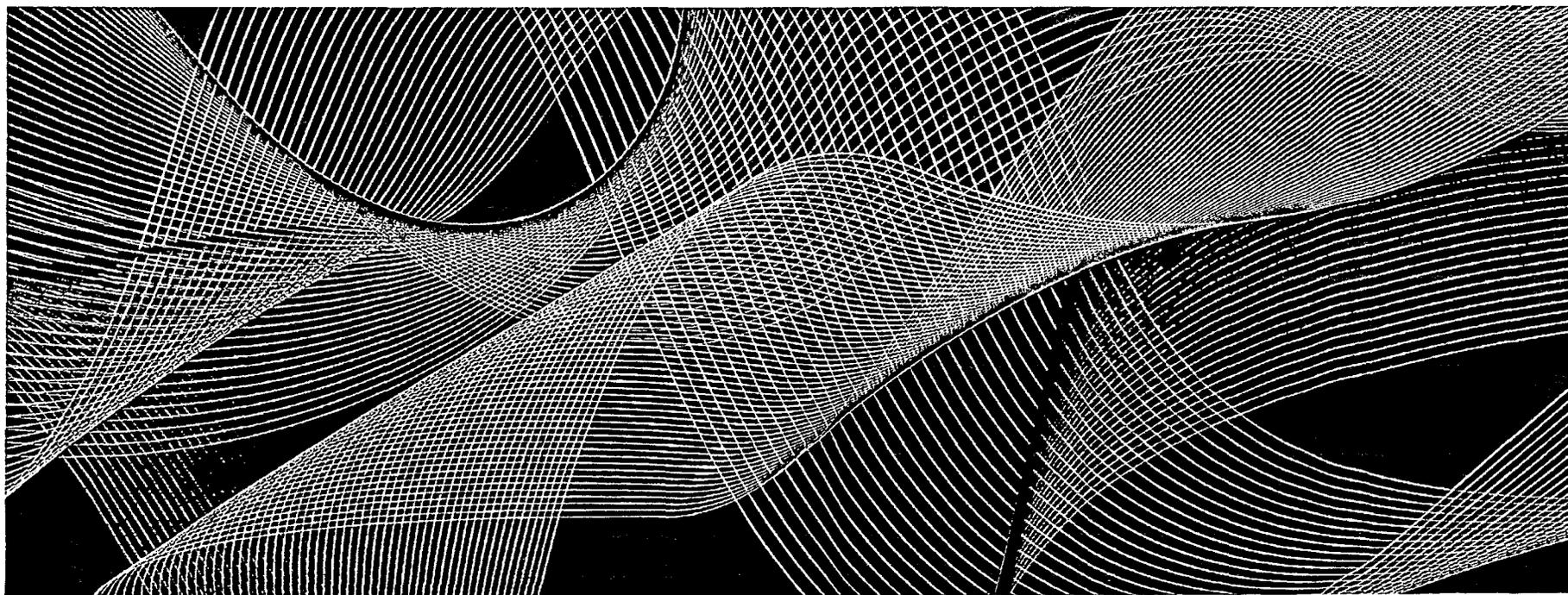


DRAFT

LEHMAN BROTHERS

June 2008

Project Green: Liquidity and Liquidity Management



Confidential Presentation

FOIA CONFIDENTIAL TREATMENT REQUESTED
BY LEHMAN BROTHERS HOLDINGS INC.

LBH1_SEC07940_844120

Table of Contents

- ◆ Introduction To The Funding Framework
 - Liquidity Pool
 - Cash Capital
 - Long-Term Debt Issuance Strategy
 - Role Of Bank Entities
 - Contingent Liquidity Risk
 - Secured Funding
 - “Overfunding”
 - Prime Broker Business
 - Use Of Commercial Paper

- ◆ Lessons From The Bear Stearns Liquidity Crisis & Recent Changes In Funding Strategy
 - Bear Stearns Liquidity Crisis
 - Changes In Funding Strategy Since Summer of 2007
 - How Lehman Brothers Managed Funding During Week Of March 17
 - Lessons of Bear Stearns Liquidity Crisis

Introduction To The Funding Framework

Overview Of The Funding Framework

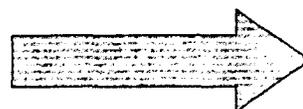
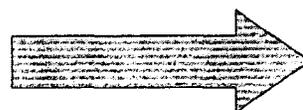
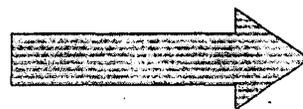
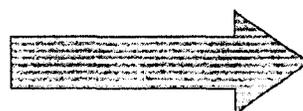
- ◆ Established in the aftermath of the liquidity event of 1998, the Lehman Brothers Funding Framework is based on a set of conservative principles guiding the funding of assets and mitigating our liquidity risk. It has been refined and augmented over the years as Lehman enters new businesses and as the liquidity risk of existing businesses changes.
- ◆ At its core are the following principles
 - Remain in a state of constant liquidity readiness
 - Do not rely on asset sales, increase in operational effectiveness or access to the unsecured debt market in a time of crisis
 - Be proactive with your key stakeholders before and during a liquidity event: regulators, creditors, trading counterparts and rating agencies
- ◆ It is structured around three dimensions
 - Liquidity pool to cover cash outflows over a 12 month horizon at the Holdings Company
 - Cash capital to cover funding of illiquid assets as well as contingent liquidity risk
 - Secured funding plan to mitigate the liquidity risk associated with short-term secured funding, including the prime broker business
- ◆ The conservativeness embedded in our Funding Framework (e.g., we fund boxed positions with cash capital, irrespective of the liquidity characteristics of the positions) is what distinguishes our Framework from that of our peers

Core Principles of Capital & Liquidity Management

Our capital & 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

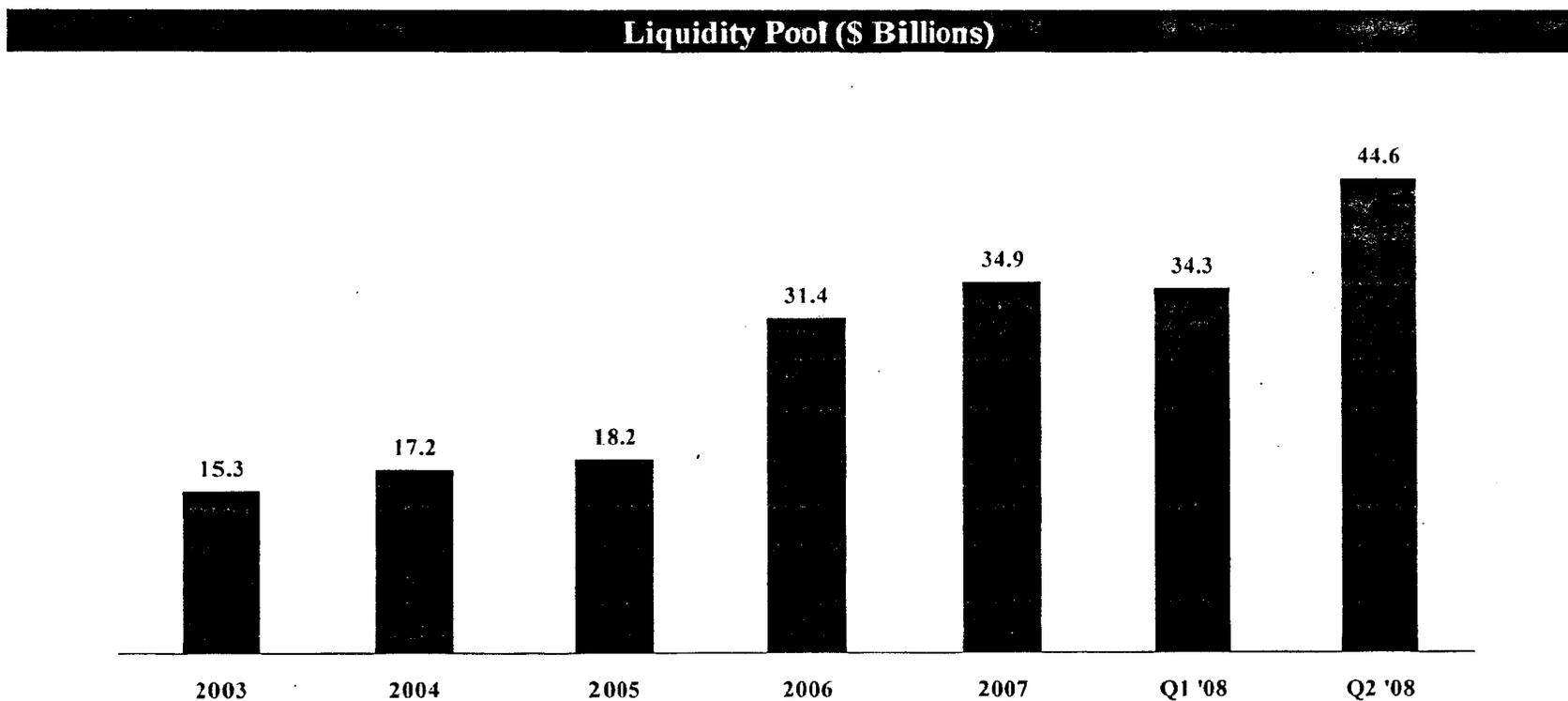


Implication To Funding Framework

- ◆ 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
- ◆ Separate Cash Capital Model for each **regulated entity** and the Holding Chain; treat all excess cash in restricted entities as 'trapped'

Liquidity Pool

- ◆ Starting in 2006, we increased the size of Holdings' liquidity to \$30-35 billion. We ended 2008 Q2 with a record \$45 billion liquidity pool.



Management Of Liquidity Pool

- ◆ Liquidity pool is managed by Treasury for the Holding Company. It is invested in cash and cash equivalents (e.g., money market funds) and good quality collateral for which we have ample unused funding capacity with external counterparts
 - Investment grade securities (Treasuries, Agencies, Corporates and Asset-Backed Securities)
 - Major index equities
- ◆ Not included in the liquidity pool are unencumbered assets (\$70 billion in unregulated subsidiaries and \$87 billion in regulated subsidiaries as of April 30) and the liquidity pools held at the bank entities and broker dealers.

Composition Of Liquidity Pool As Of May 30, 2008 \$ Millions

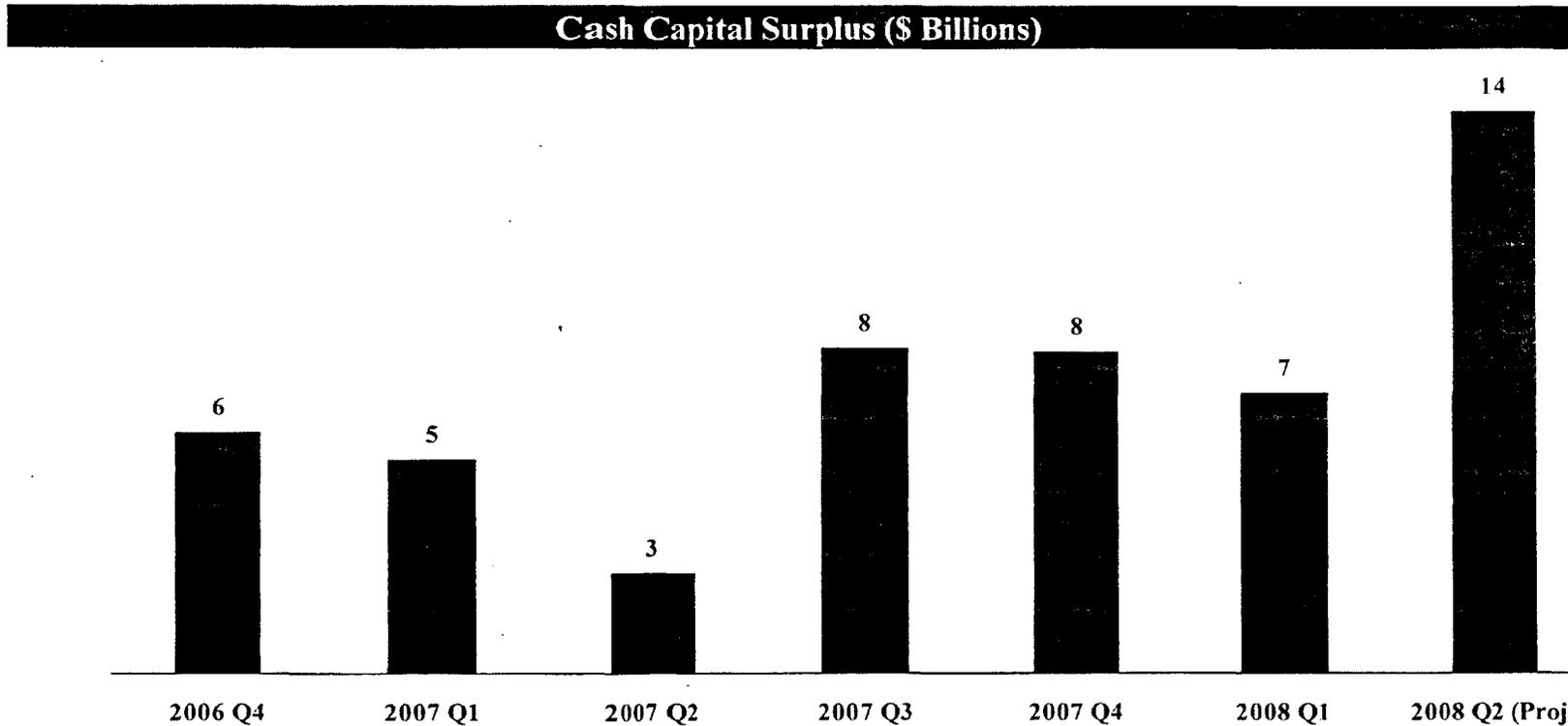
Investment Type	Pledge Value*			
	LBHI Pledge Value New York Inv	LBI Pledge Value New York Inv	LBIE Pledge Value Europe Inv	Total Pledge Value Global Inv
1. Cash				
Bank Deposits	2,122	1,300	-	3,422
Other Cash Inv	583	-	-	583
Money Funds	116	-	-	116
Total Cash	A	2,821	1,300	4,121
2. Boxed Inventory				
2.1 Tri-party eligible				
Private Label CMO's	1,473	-	-	1,473
Corporates	974	-	-	974
Governments / Treasuries	12,430	1,793	9,328	23,552
Asset Backed	1,453	-	-	1,453
Agencies	11,828	-	1,241	13,069
Sub-total Tri-party eligible boxed inventory	B	28,157	1,793	40,520
C&C Equivs Available to Holding Company (A+B)		30,977	3,093	44,640
Undrawn Committed Facilities				
Chase Facility				2,000
European Facility				2,500
C&C Equivs Available to Holding Company				49,140

Notes:

*Pledge value = Market Value of the collateral * normal mkt haircut for each asset class

Cash Capital Surplus

- ◆ Holdings' cash capital surplus had historically fluctuated in a range of \$2-6 billion. During the summer of 2007, we conservatively increased the target to \$4-8 billion. We project ending the quarter with a \$14 billion cash capital surplus.



Management of Cash Capital

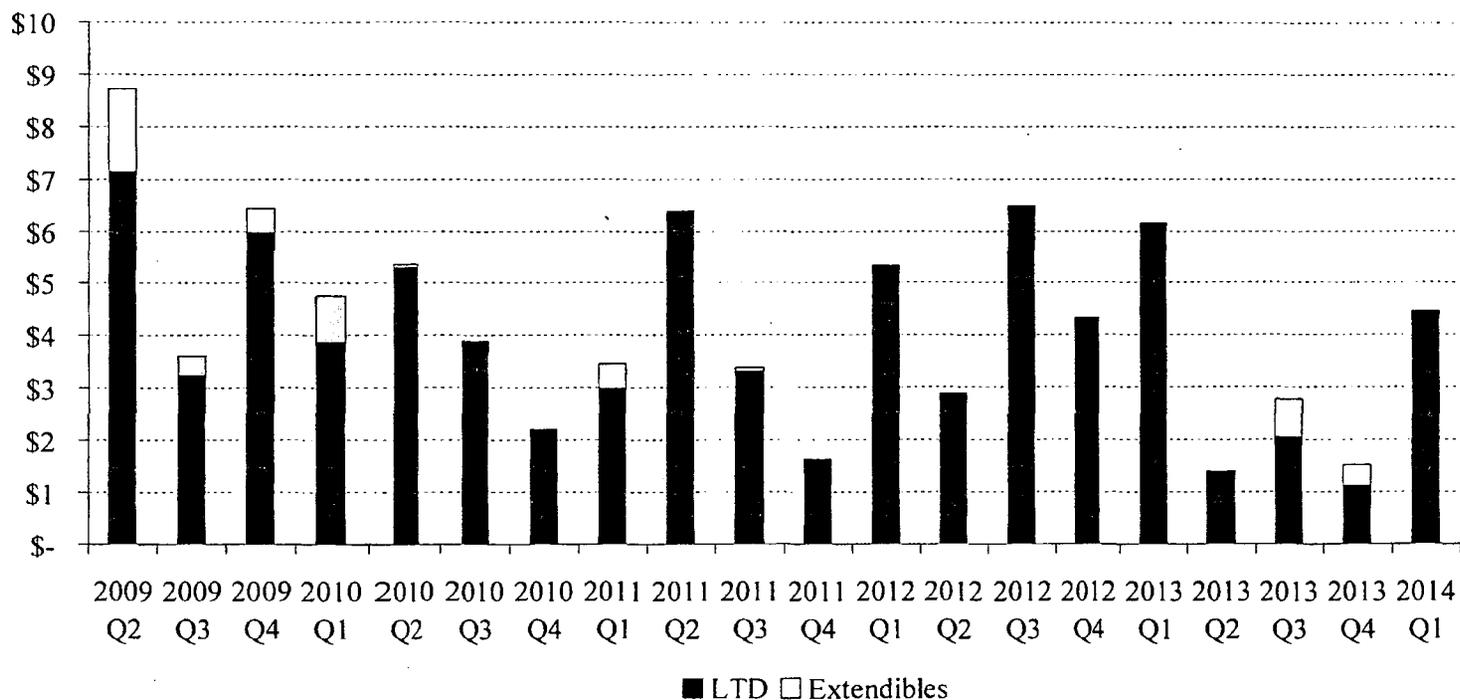
- ◆ Cash capital sources at the Holding Company include:
 - Long-term capital (equity and long-term debt with at least one year of expected life)
 - Secured bank lines, typically extendibles, with at least one year till maturity
 - No reliance on hot money such as customer free credits, short term debt
 - Additionally, we also have two syndicated committed unsecured facilities with an overall capacity of \$4.5 billion, which are drawn from time to time and provide additional funding flexibility to Lehman Brothers

- ◆ We conservatively assess cash capital uses
 - Illiquid positions, which are completely funded with cash capital. We determine whether a position is illiquid by looking at its fundability in a stress liquidity event. This includes corporate loans and commercial whole loans.
 - Haircuts on funding liquid positions on a secured basis. We see the haircut (i.e., the difference between market and pledge values) as a cash capital use. Haircuts are conservatively estimated and regularly reviewed based on actual Lehman funding experience.
 - Boxed assets, irrespective of their liquidity characteristics (e.g., equities and corporate loans are treated the same way)
 - Derivatives receivables
 - Cash at banks, which is not managed as part of a liquidity pool, is also presumed to be “illiquid” in the sense that it cannot be used to meet a payment due to some operational friction (e.g., it is used in an escrow account).
 - Prefunding on unfunded loans used to mitigate contingent liquidity risk

Managing Long-Term Debt Rollover Risk

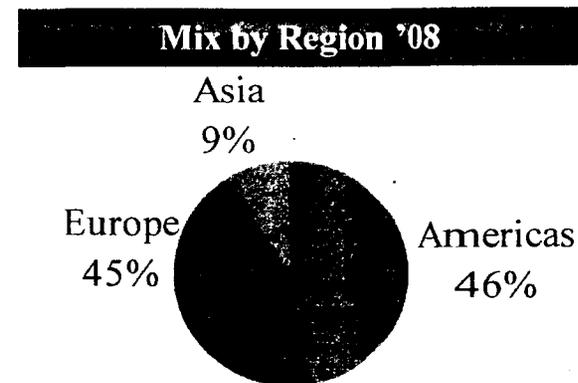
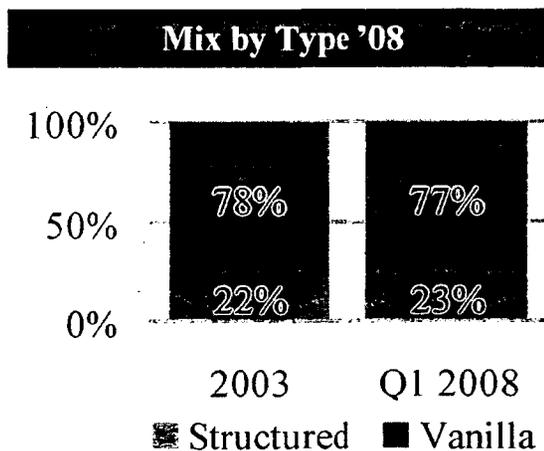
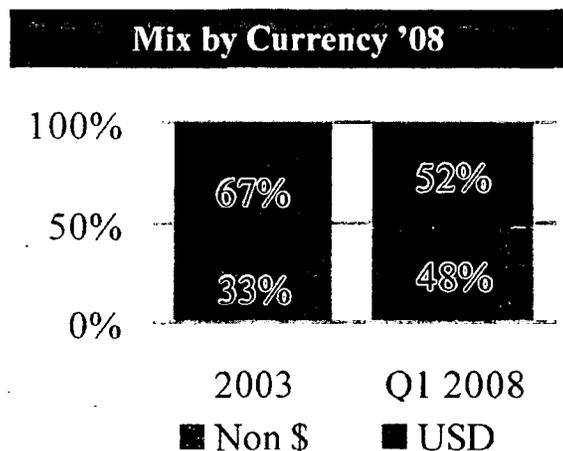
- ◆ In order to minimize refinancing risk, we have established threshold amounts (stated as percentages of outstanding long-term borrowings) on long-term borrowings anticipated to mature within any quarterly (12.5%), half-year (17.5%) and full-year (30.0%) interval. At February 29, 2008, those limits were \$16.0 billion, \$22.5 billion and \$38.5 billion, respectively. If we were to operate with debt above these levels, we would not include the additional amount as a source of cash capital.

2008 Q1 Long-Term Maturity Schedule (\$ Billions)



Funding Diversification

- ◆ We diversify our issuances by currency, type and region to broaden our debt investor base
 - Currency sources: Our currency base is diversified, approximately 48% of Lehman Brothers’ long-term debt was issued in currencies other than USD
 - Funding instruments: In addition to plain vanilla debt, we diversified our funding base by issuing structured notes
 - Investor base: Lehman Brothers diversified its issuances geographically to broaden the debt holder base. Approximately 53% of Lehman Brothers’ long-term debt portfolio was issued in Europe and Asia



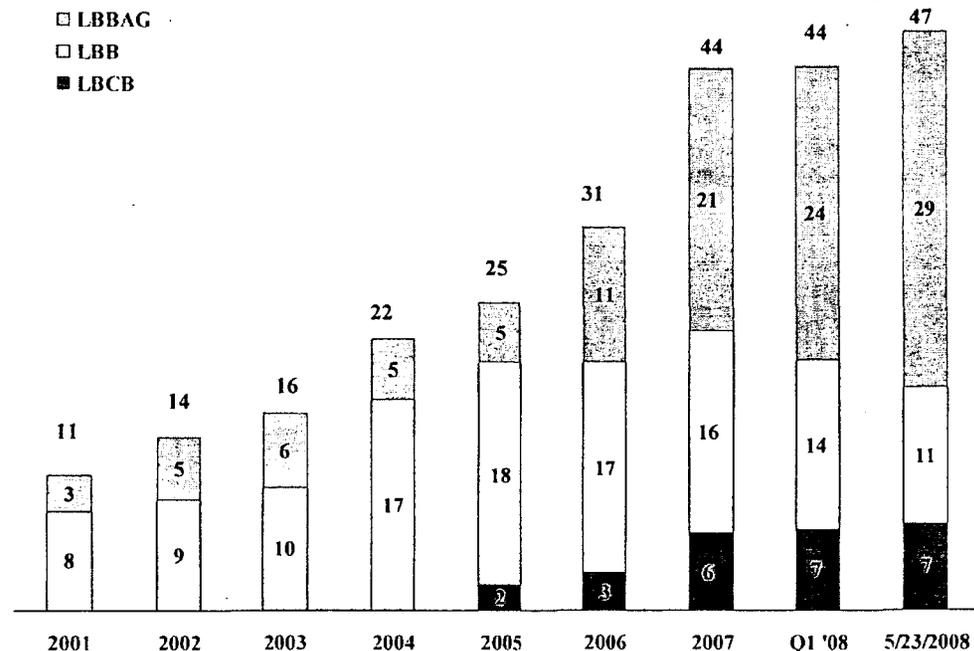
Rapid Asset Growth At Lehman Brothers-Owned Banks

- ◆ Lehman's 3 banking entities are all benefit to raise cost-effective financing in a depositor-protected environment (proved extremely reliable).
- ◆ Additionally, the Bankhaus has access to the lending facilities of the European Central Bank (ECB) and the Bundesbank. The ECB has a \$700 billion lending facility accepting a wide range of good quality fixed income collateral, which commercial banks in the Euro zone use regularly for large amounts. The Bankhaus borrows approximately \$9.5 billion under this program.

Lehman 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

Lehman Banking Entities – Total Assets (\$Billions)



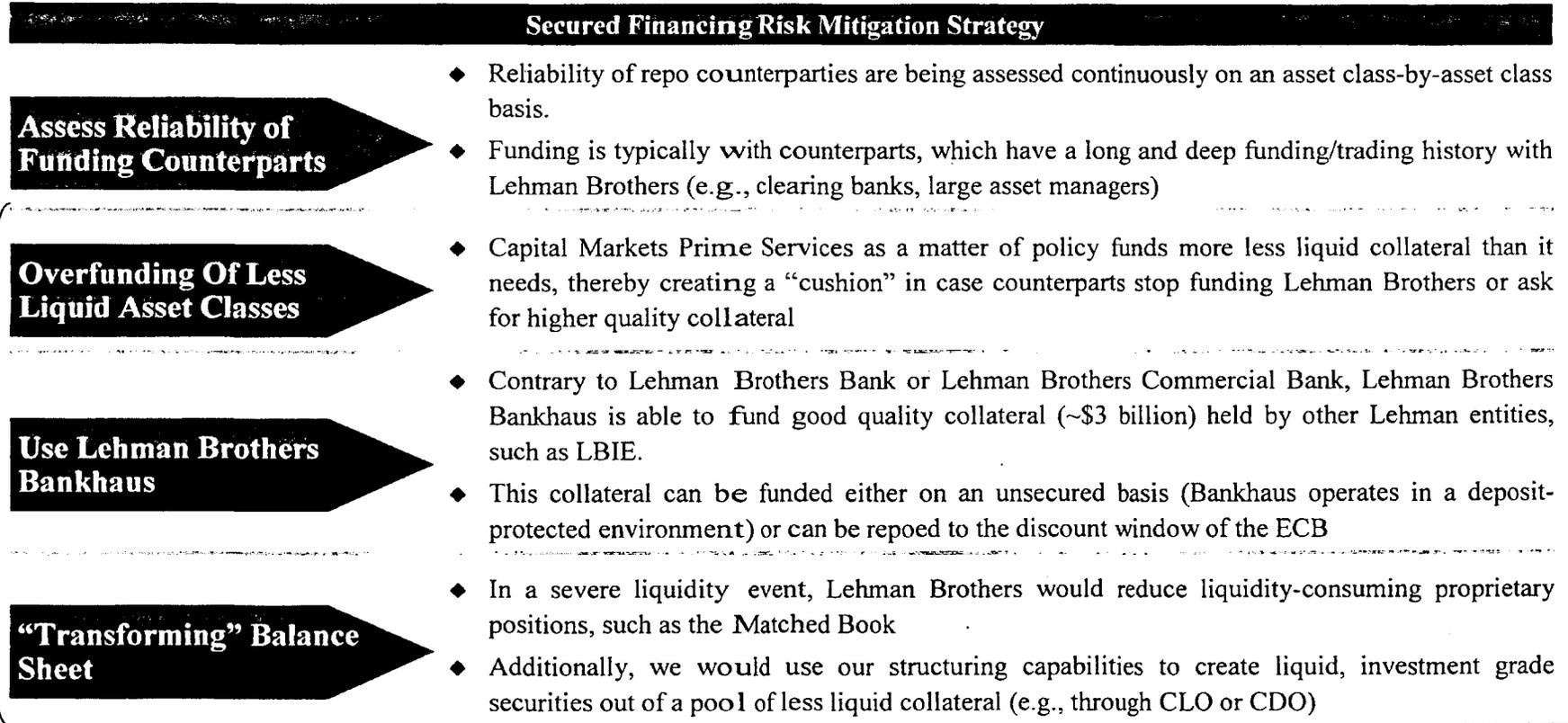
Contingent Liquidity Risk

- ◆ The Funding Framework is designed to set rules in order to protect Lehman in a stress liquidity environment. In a stress environment, whether Lehman-specific or market-wide, we plan for an increase in cash capital requirements due to
 - Unfunded loan commitments that get drawn due to a contraction in the market liquidity or due to a series of credit events impacting Lehman's banking clients.
 - Downgrade of Lehman's ratings
- ◆ Lehman has a large unfunded loan commitment portfolio – primarily as a result of long-term relationships with its clients.
 - As of February 2008, this portfolio amounted to \$26.3 billion for its high grade loan portfolio and \$12.5 billion for its high yield loan portfolio.
 - This portfolio is very diversified across clients and industries, which is an effective liquidity risk mitigant.
 - To further mitigate the risk, we book the majority of our loan commitments in our bank entities, which are best suited to handle this risk because they have access to the insurance-protected deposit markets and the Central Bank and, in the case of the U.S. bank entities, FHLB borrowing windows.
 - Additionally, we prefund the liquidity risk with cash capital based on a quantitative assessment of the draw, which is takes into account client ratings and industries.
- ◆ A downgrade of Lehman's ratings would mechanically result in an increase in cash capital requirements – primarily due to additional cash collateralization of our derivatives receivables.
 - The increase in funding requirements due to a one-notch downgrade is also funded with cash capital.

Managing Secured Liquidity Risk

Short term secured financing represents the largest source of secured funding for the firm. Consequently, one of our key objectives is to insure that we maintain these funding sources in adverse market environments. We do not want to put Lehman Brothers in a position where a lack of liquidity results in an impairment of the franchise.

Lehman Brothers manages its 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.



Reliable Funding Counterparts

- ◆ Top 20 counterparties account for about 80% of the repo book, outside of Governments and Agencies.
 - Reliable counterparts with which Lehman has strong relationships such as clearing banks and large trading clients

Repo Book Principal Amount By Counterparty And Asset Class Allocated (\$ Billions) – May 8, 2008

Counterparty	IG ABS	HY ABS	IG Conv.	HY Conv.	IG Corp.	HY Corp.	EMG	Equities	Money Markets	Muni	IG CMO	HY CMO	Total	% Total
A	1.0	0.2	0.0	0.2	4.1	1.7	0.6	2.9	1.0	1.3	2.0	1.1	16.3	15%
B	5.4	0.4	0.2	0.1	0.1	0.2	0.5	2.3				0.0	9.1	8%
C	8.0				0.1								8.1	7%
D	0.4		0.4	0.1	1.3	0.7	0.9	1.6	0.8	0.6	0.2	0.0	7.0	6%
E	1.3	0.2	0.6	0.0	0.4	1.8		0.5		1.9	0.0	0.0	6.7	6%
F	1.3	0.0			0.0				3.0		0.9	0.2	5.5	5%
G			0.2	0.1	1.3	0.1	0.2	2.8					4.7	4%
H	0.0										4.6	0.1	4.7	4%
I	0.3	0.0				0.2		0.9	0.5		2.2	0.0	4.0	4%
J	1.3	0.0		0.0	0.9	0.1	0.5						2.9	3%
K	0.2		0.0	0.4	0.0	0.2	1.1	0.8					2.7	2%
L	1.0	0.0		0.1	0.2	0.5		0.5	0.2		0.0	0.0	2.5	2%
M	0.0		0.1	0.2	0.5	0.2	0.1	1.1					2.2	2%
N	0.3	0.0	0.0	0.2	0.0	0.1	0.9	0.5	0.0		0.0	0.0	2.0	2%
O	0.4				0.6	0.0		0.8		0.0	0.0	0.1	2.0	2%
P							0.0	1.9					1.9	2%
Q	0.0	0.6			0.8	0.0					0.1	0.4	1.9	2%
R			0.0	0.5	0.0	0.0	0.1	1.1					1.8	2%
S	0.7	0.1			0.3	0.0		0.0	0.6		0.0		1.7	1%
T									1.5				1.5	1%
U	0.0		0.0	0.2	0.3	0.1	0.2	0.3					1.2	1%
Other (58 counterparties)	0.5	0.8	0.1	0.6	5.2	1.8	2.5	7.2	2.4	-	1.4	0.5	22.9	20%
Total	22.1	2.3	1.6	2.6	16.0	7.6	7.5	24.9	9.9	3.9	11.3	2.4	112.0	100%

Reducing Liquidity Risk Of Secured Funding

- ◆ We have increased our overfunding from around \$10-15 billion to \$15-20 billion – more than half in non-Central Bank eligible collateral – primarily high yield corporates
 - Including excess collateral (i.e., collateral reversed to fill repo tickets), the excess repo capacity stood at close to \$30 billion on May 22 – 30% of the Firm and customer collateral funded that day
- ◆ We also increased the average tenor of the repo book from 20-25 days to 25-35 days (35-40 days for collateral that cannot be pledged to the Federal Reserve or the ECB)
- ◆ We are seeing increasing appetite for providing term funding and have raised \$5 billion of additional term financing in the past few weeks

Non-Traditional ⁽¹⁾ Repo Book Metrics

	29-Feb	4-Mar	14-Mar	2-Apr	22-May	3/14 - 5/22 Change
Repo Book (\$ Billions)						
Excess collateral		Not available			12.8	
Firm and customer collateral					98.9	
Allocated Collateral	116.4	114.0	115.3	108.3	111.7	-3%
Overfunding	9.2	14.6	12.7	18.0	17.1	35%
Repo Capacity	125.6	128.6	128.0	126.3	128.8	1%
Excess Repo Capacity	9.2	14.6	12.7	18.0	29.9	N/A
Average tenor (days)						
Grand Total	25	22	24	25	33	38%
<i>Central Bank Eligible Collateral</i>					26	
<i>Non Central Bank Eligible Collateral</i>					38	
% Repo Book With Maturities <= 1 Week	58%	58%	57%	52%	46%	-11%

1. Non-traditional repo book excludes Governments, Treasuries, Government/MBS Agencies and Sovereigns

Liquidity Risk Of Prime Broker Business

- ◆ Prime brokers provide clients with a range of centralized record keeping, clearing and custodial services. Other core services include financing of securities positions and access to a supply of both liquid and illiquid securities for borrowing / short covering.
- ◆ Prime broker business is typically a cash generating business because the equity (customer free credit balances) and margin requirements are typically in excess of the actual cash requirements of the business (financing and short covering haircuts as well as the customer collateral left in the box)
 - The key funding principle for our prime broker business is that it should be self-sufficient. As a result, we typically generate enough cash to cover the withdrawal of the customer free credit balances, mitigate the risk of reduction in secured funding (either through haircut widening or loss of counterparties) and in operational effectiveness (e.g., increase in the amount of collateral in transit across depots).
- ◆ Regulatory requirements and client protection provisions can result in excess cash generation not being available to the broker dealers, LBI in the US or LBIE in the UK
 - In the U.S., SEC regulation 15c3 requires broker dealers to segregate any excess liquidity generated by the prime broker business
 - 15c3 lock ups are measured on a weekly basis, although they can be done more frequently in terms of extreme market volatility
 - In the UK, prime broker clients have the option of requiring a similar treatment, although, in practice, few do so

Net Cash Generation Of Prime Broker Business in LBIE

- ◆ We manage the prime broker business in LBIE to be cash generative to make sure that the business is self sufficient from a funding perspective at all times. Cash generation covers
 - Customer free credit balances
 - Operational friction (change in lock ups, transfer of positions across depots, change in secured funding, etc.)
- ◆ Major sources of cash generation are the customer free credit balances, margins deposited by customers, proceeds from short sales and proceeds from repo financing of long positions. Major sources of cash usage are the short covering, financing haircuts, futures margins and other exchange requirements.
- ◆ In practice, the financing and short covering of the prime brokerage positions are comingled with the financing and short covering of our own inventory positions. As a result, it is possible for the prime broker short positions to be covered by Lehman's long inventory positions (and vice versa).

Prime Broker Business: Net Cash Generation As of May 8, 2008 (\$ Billions)

	Cash Generation	Cash Usage	Balance
Long Financing	71	(64)	7
Short Covering	56	(58)	(2)
Customer Free Credits	4		4
Total	131	(122)	9
LBIE Liquidity Pool			9

Prime Broker Committed Facilities

- ◆ Term prime broker funding facilities are match funded with committed repo facilities of similar or longer term for all assets except investment grade corporates, which are typically Fed and ECB-eligible, and major index equities (E1).
- ◆ While we offer committed margin facilities, our commitment only extends to the funded portion. We have the right to refuse any increase in margin. We have the right to veto new collateral. We have limitations on increases in leverage.

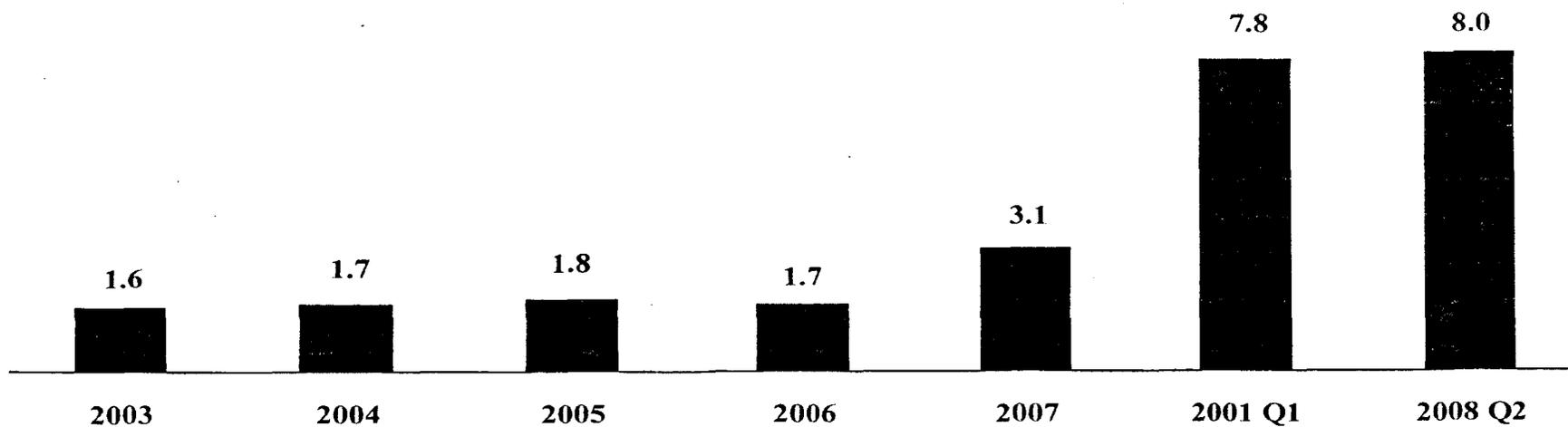
Committed Facilities As of May 9, 2008 (\$ Millions, Days)

<u>Current Position</u>	<u>E1</u>	<u>E2</u>	<u>E3</u>	<u>G1</u>	<u>C1</u>	<u>K1</u>	<u>C2/K2</u>	<u>HY</u>	<u>Total</u>
	<u>Major Index Equities</u>	<u>Tier II Equities</u>	<u>Other Equities</u>	<u>Gov'ts</u>	<u>Investment Grade Conv't</u>	<u>Investment Grade Corps</u>	<u>Non Investment Grade Debt</u>	<u>High Yield</u>	<u>Total</u>
<u>Committed Margin Facilities</u>									
Committed Margin Facility Funding Requirements	5,518	8,126	1,362	132	720	1,366	4,177	279	21,680
Term Funding %	<u>25%</u>	<u>100%</u>	<u>100%</u>	<u>0%</u>	<u>100%</u>	<u>25%</u>	<u>100%</u>	<u>100%</u>	<u>76%</u>
Term Funding Requirement	1,379	8,126	1,362	-	720	341	4,177	279	16,385
<u>Term Funding Outstanding</u>									
Repo Trades	616	3,432	2,618	-	381	500	6,422	279	14,248
Upgrades / Exclusives	2,310	800	-	-	-	-	1,446	-	4,556
Total Term Funding Trades Outstanding	2,926	4,232	2,618	-	381	500	7,868	279	18,804
Current Liquidity Position	1,547	(3,895)	1,256	-	(339)	159	3,691	-	2,419
Cusip Netting Benefit	423	1,702	163	-	72	21	440	-	2,821
Current Liquidity Position Inc. Cusip Netting	1,970	(2,193)	1,420	-	(267)	179	4,131	-	5,240
Wgt Avg Life of Commitments									96
Wgt Avg Life of Term Funding Facilities									138

Commercial Paper

- ◆ We 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. We do not use commercial paper to fund core requirements or illiquid assets because they are not a good source of cash capital.
- ◆ We issue overnight commercial paper for two reasons
 - As a way to introduce new investors to our 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.
 - We conservatively do not attribute any liquidity value to our overnight CP program even though there is still a market, albeit a small one, in most market environment (\$2.4 billion issued on March 17)

Commercial Paper Outstanding (\$ Billions)



**Lessons From The Bear Stearns Liquidity Crisis
& Recent Changes In Funding Strategy**

What Happened At Bear Stearns

- ◆ “The Bear Stearns experience has challenged the measurement of liquidity in every regulatory approach, not only here in the United States but around the world.”
 - SEC Chairman Cox, Letter to Senator Grassley; April 16, 2008

- “Short-term secured financing was unavailable even when Bear offered high-quality collateral such as agency securities. (...) The course of events that week was a cascade of panic against which even a larger and less leveraged firm might have been defenseless. At first, some counterparties began pulling back from providing unsecured lending. Then the same reluctance to deal with Bear was extended to secured lending on less liquid and lower-quality securities. Some skittish prime brokerage clients began moving their cash balances elsewhere. As rumors swirled about Bear's financial position, these actions in turn influenced other counterparties. Clients and lenders began also to reduce their exposure to Bear Stearns. This, in turn, created large volumes of novations of derivative contracts.
- In the face of what was essentially the wholesale transfer by counterparties of their open contracts with Bear Stearns to other dealers, the industry faced a number of significant logistical challenges. Not surprisingly, there was a sharp increase in the number of collateral disputes involving Bear Stearns. These disputes reinforced the market's impression that Bear Stearns was distressed. And that, in turn, induced more novations by other counterparties.
- By week's end, Bear Stearns could no longer fund certain high-quality debt instruments on a secured basis. They faced a choice between filing for bankruptcy on Monday morning, or concluding an acquisition agreement with a larger partner.”
 - SEC Chairman Cox, Address to the Security Traders 12th Annual Washington Conference, May 7, 2008

Lehman Brothers Is Different From Bear Stearns

- ◆ Lehman Brothers had stronger liquidity metrics at the end of Q1 '08 than Bear Stearns
 - 60% greater balance sheet but 130% greater equity
 - Bear Stearns' short-term debt stood at 1.5x its liquidity pool vs. 1.0x for Lehman Brothers
- ◆ Bear Stearns had very few unencumbered assets
 - Half of BSC STD was secured, which might have exacerbated the liquidity crisis in view of the exceptionally low amounts of unencumbered assets
- ◆ Bear Stearns was very reliant on customer free credit balances; if it lost these, it would need to quickly create substantial secured funding capacity for equities at a time when lenders would be likely to pull away
- ◆ Bear Stearns had almost no margin for error in terms of liquidity management. A reduction in short-term debt or in customer free credit balances would leave it in a precarious liquidity position

Q1 '08 Key Liquidity Metrics (\$ Billions)

	<u>Bear Stearns</u>	<u>Lehman Brothers</u>	<u>LEH / BSC</u>
Net balance sheet	254	397	1.6x
Net Leverage	22.6x	15.4x	0.7x
Liquidity pool	17	34	2.0x
STD excluding current portion	16	16	1.0x
Current portion of LTD	10	(E) 19	1.9x
Total short-term debt	26	35	1.3x
Short-term debt / Liquidity pool	1.5x	1.0x	0.7x
Unencumbered assets	14	161	11.5x
Free credit balances	43	13	0.3x

Lehman Brothers Would Have Reacted Differently

Bear Stearns Liquidity Crisis

- ◆ “At first, some counterparties began pulling back from providing unsecured lending.”
- ◆ “Then the same reluctance to deal with Bear was extended to secured lending on less liquid and lower-quality securities.”
- ◆ “Some skittish prime brokerage clients began moving their cash balances elsewhere.”
- ◆ “As rumors swirled about Bear's financial position, these actions in turn influenced other counterparties.”
- ◆ “Clients and lenders began also to reduce their exposure to Bear Stearns. This, in turn, created large volumes of novations of derivative contracts.”

- SEC Chairman Cox, Security Traders 12th Annual Washington Conference, May 7, 2008

Lehman Brothers

- ◆ No reliance on short-term unsecured funding. Liquidity framework assumes that unsecured debt cannot be rolled in a liquidity event
- ◆ More conservative secured funding approach
 - Less liquid assets (e.g., mortgages) funded with cash capital
 - Overfunding in lower quality collateral (e.g., high yield corporates) to avoid having to rely on new funding
 - Overfunding amounts to ~\$29 billion
 - More reliance on term funding
 - 38 days average repo tenor for non-Central Bank eligible collateral
 - Very well coordinated and proactive program of communicating with our creditors during the liquidity event. All senior management, including Dick Fuld, involved in calling key contacts at counterparties
- ◆ Prime broker business overfunded by reposing long positions to avoid relying on customer free credit balances
- ◆ Lock ups calculated on a daily basis during a liquidity event
- ◆ Treasury, Investor Relations and Corporate Communications are in constant communication with key stakeholders. Significant amount of senior management's time spent to address rumors and to reassure key stakeholders
- ◆ No change in “business as usual” philosophy. Disputed calls in derivatives businesses are normal considering lack of transparent marks in the OTC derivatives markets

Recent Modifications In Funding Strategy

- ◆ Since last summer, when the funding and trading environment became more challenging, we have made a series of modifications in our funding strategy in order to strengthen our liquidity fortress:
 - Increase our cash surplus targets from \$2-5 billion to \$4-7 billion
 - Front load our issuance program – we completed our benchmark issuance plan by early May
 - Increase funding of illiquid assets in our bank entities – particularly Lehman Brother Bankhaus
 - “Overfund” repos for harder to fund asset classes, such as high yield corporates, to mitigate risk of loss of secured funding capacity
 - Increase our CP program to mitigate risk of operational friction in a very volatile environment
 - Started a program to securitize illiquid assets such as corporate loans and commercial whole loans. The resulting securities, which are rated, can then be pledged to counterparties or Central Banks.
 - Discuss our liquidity management and position more proactively with creditors, trading counterpart, rating agencies and other stakeholders

- ◆ As a result, we were well prepared to face the extraordinarily difficult funding environment of the week of March 17
 - Started the week with a strong liquidity position
 - Entire Firm was fully engaged defending the “Liquidity Fortress”
 - Active communication with clients with quick escalation to senior management if necessary
 - Lehman senior management proactively involved in calling their counterparts at key relationships to put pressure on traders who refused to trade with Lehman
 - Great coordination between Front Office, Finance and Operations to minimize any operational friction

Liquidity Event Of Week Of March 17 (I) – Broker Dealers

- ◆ During the week of March 17, Lehman Brothers was under significant funding pressure, which we were able to mitigate through a series of actions
 - Secured Funding
 - We started the week with \$13 billion of repo overfunding in harder to fund asset classes
 - We also funded an additional \$4.5 billion of collateral through Bankhaus where we have been building excess capacity since the summer of 2007
 - Prime Broker
 - We absorbed the loss in prime broker cash balances by relying on the LBIE “excess” liquidity pool (which, because it was “trapped,” was not included in the LBHI liquidity pool) and by recalculating the lock up on a daily basis
 - LBI experienced a very modest (\$75 million) loss of liquidity in prime broker cash balances that week.
- ◆ As a result, the loss of liquidity experienced by the broker dealers was absorbed within the broker dealers and did not require the use of the Holding Company liquidity pool

Key Liquidity Inflows/Outflows During Week Of March 17 (\$ Billions)

	Secured Funding			Prime Broker (LBIE)		
	Decreases	Increases/ Upgrades	Balance	Decreases	Increases	Balance
17-Mar	(8.7)	3.2	(5.5)	(5.0)	0.8	(4.2)
18-Mar	(3.8)	-	(3.8)	(2.7)	2.8	0.1
19-Mar	(3.0)	5.1	2.1	(1.2)	1.5	0.3
20-Mar	-	-	-	(1.2)	1.1	(0.1)
21-Mar	Market Closed (Good Friday)					
Total	(15.5)	8.3	(7.2)	(10.1)	6.2	(3.8)
Mitigation strategy						
Overfunding repo book	2.7			LBIE excess liquidity pool	3.8	
Bankhaus funding	4.5					
Total	7.2					
"Dry powder" : Overfunding repo book	~10					

Liquidity Event Of Week Of March 17 (II) – Holdings

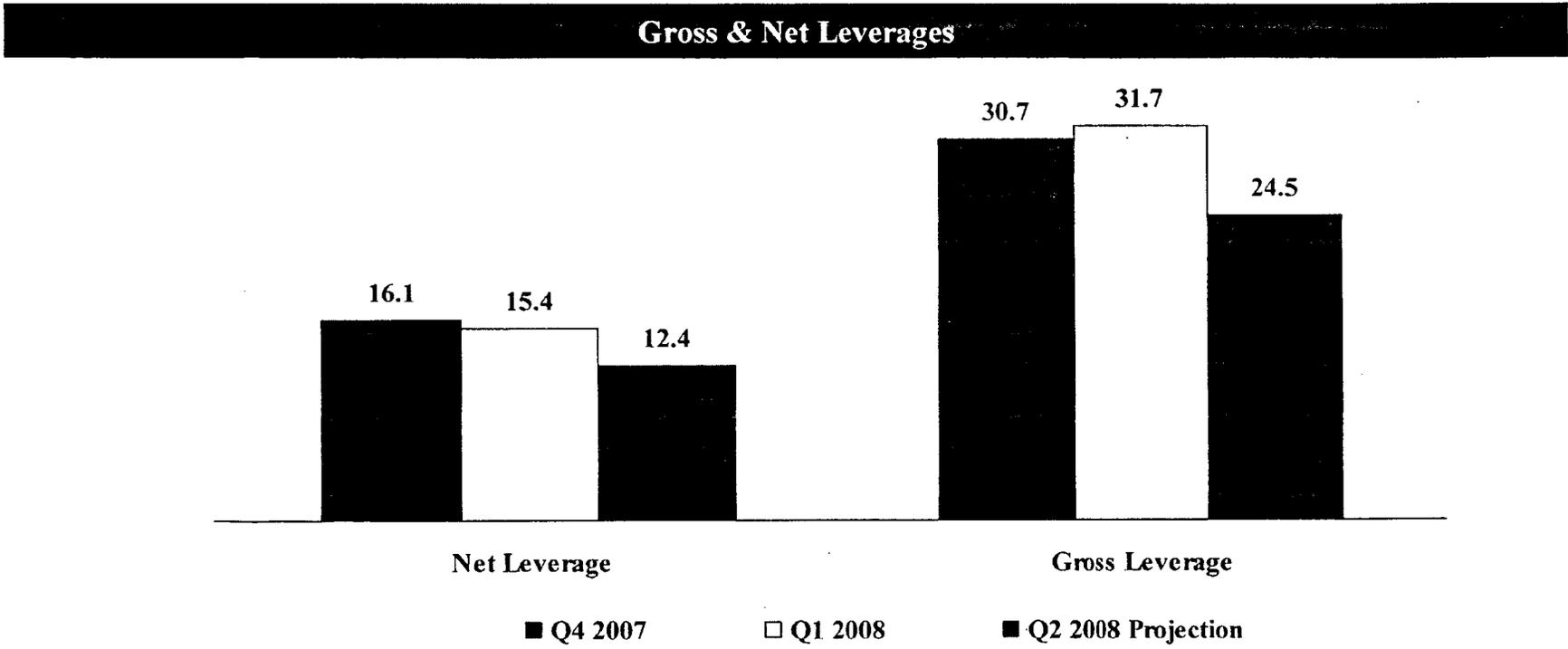
- ◆ Holdings also faced funding pressure – primarily due to the reduction of its commercial paper program and, to a lesser extent, the posting of derivative margins
- ◆ We mitigated this loss of liquidity by:
 - Increasing operational effectiveness: we executed on a plan developed over the weekend to reduce the amount of trapped cash in LBI and increase funding in Bankhaus. These actions generated approximately \$3 billion on March 17
 - Launching the Freedom CLO and executing a previously planned European securitization
 - Drawing on our European committed facility. We draw on our committed facilities 33-50% of the time to avoid any signaling effect

Key Liquidity Inflows/Outflows During Week Of March 17 (\$ Billions)

	Commercial Paper				Derivatives in/(out)flows Balance	Operational effectiveness Balance	Other Balance	LBHI Liquidity Pool			Other Details
	Maturities	Issued	Balance	O/S (EOD)				SOD	EOD	Change	
17-Mar	(6.2)	2.2	(4.0)	7.9	(0.0)	3.0	0.0	31.1	30.1	(1.0)	
18-Mar	(3.2)	3.7	0.5	8.4	(1.2)	(0.4)	(0.1)	30.1	28.9	(1.2)	
19-Mar	(3.5)	3.3	(0.2)	8.2	0.9	-	0.7	28.9	30.3	1.4	European mortgage securitization
20-Mar	(3.1)	3.4	0.3	8.5	(1.0)	-	3.1	30.3	32.7	2.4	Draw on committed facility, Freedom
21-Mar					Market Closed (Good Friday)						
Total	(16.0)	12.6	(3.4)		(1.3)	2.6	3.7	31.1	32.7	1.6	

Deleveraging The Firm

The Firm has set aggressive targets to reduce balance sheet and cash capital usage below their Q4 2007 levels by the end of this quarter. We expect to report net leverage of ~12.4x and gross leverage of ~24.5x for 2008 Q2 quarter end.



Building A Liquidity Fortress

- ◆ Thanks to its conservative funding framework, Lehman Brothers entered the week of March 17 in a strong liquidity position
 - Liquidity pool of \$30 billion
 - Cash capital surplus of \$5 billion
 - ~\$15 billion overfunding in the repo book - ~\$7 billion of which in high yield securities
 - Average tenor of repo book of 24 days (excluding Governments and Agencies)

- ◆ Since then, we have taken significant measures to strengthen our liquidity position further
 - Started an active program of deleveraging, discussed previously, which is projected to free up ~\$5-10 billion of cash capital
 - Raised \$9.5 billion of cash capital through preferred, subordinated and senior debt issuances, which, coupled with the deleveraging effort, essentially completes our debt issuance requirement for the year ⁽¹⁾
 - Increased overfunding in the repo book to \$18 billion - \$8 billion of which in high yield securities
 - Grew the average tenor of repo book of 29 days (excluding Governments and Agencies)
 - 37 days excluding collateral that can be pledged to the Federal Reserve or ECB

- ◆ We project that at quarter end Holdings' liquidity pool and cash capital surplus stood at a record \$45 billion and \$14 billion, respectively.

1. See appendix for details

Legal Entity Structure

- ◆ Legal entity structure constrains liquidity flows which are explicitly accounted for in our funding framework
 - ◆ Holdings Company Chain
 - LBHI: Holding company
 - LBF and LBSF: Derivatives subsidiaries
 - LB Treasury Co. BV: Main European debt issuing entity
 - ◆ Broker dealers
 - LBI, Neuberger Berman and LOTC: U.S. broker dealers
 - LBIE: European broker dealers
 - LBJ: Japanese broker dealers
 - ◆ Bank Entities
 - Lehman Brothers Bank: Delaware-based thrift
 - Lehman Brothers Commercial bank: Utah-based industrial bank
 - Lehman Brothers Bankhaus: German bank
- Issues nearly all unsecured debt
 - Holds mostly illiquid (100% cash capital) assets
 - Funded with equity and debt from Holdings (LBI also has some external debt)
 - Primarily securities trading, including prime brokerage
 - Bulk of securities are being funded on a secured basis
 - Funded with equity and sub debt from Holdings
 - Raise insured term funding (brokered CDs in the U.S.)
 - Primarily fund whole loans and corporate loans
 - Access FHLB system to fund whole assets
 - Also access ECB discount window

Contingency Funding Plan

Philosophy and Guiding Principles Of The Funding Framework

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.

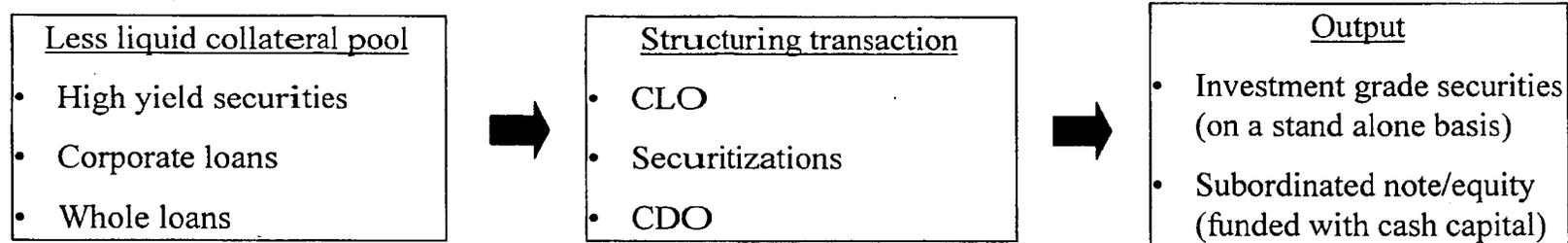
Recent Benchmark Issuances

- ◆ We issued \$9.5 billion in four benchmark issuances since the start of the quarter
 - \$4.0bn of non-cumulative perpetual convertible preferred stock
 - Dividend of 7.25% per annum
 - More than three times oversubscribed
 - \$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
 - \$2 billion 30-year subordinated debt
 - Treasuries + 305 bps
 - \$4.0 billion of orders within 1 hour

- ◆ As a result, we have completed our debt issuance program for the rest of the year
 - We may issue further during the latter part of the year to “pre fund” 2009 debt issuance requirements however

Less Liquid Assets

- ◆ At a fairly short notice (1-2 weeks), Lehman Brothers can “transform” less liquid assets such as high yield securities or loans into investment grade securities, which can be treated as any other investment grade securities from a secured funding perspective and a subordinated note/equity, which would be funded with cash capital.
- ◆ We created \$16 billion of additional liquidity through these securitizations YTD



Selected CLO Transactions (Millions)

	Corporate Loan Value	Senior Investment Grade Notes	Mezz Non-Investment Grade Note	Sub Unrated Note
Freedom Initial *	\$2,825	\$2,260	\$0	\$565
Freedom Revised **	\$1,926	\$1,541	\$250	\$135
Spruce ***	\$1,874	\$1,462	\$244	\$169
Talia ****	€ 1,110	€ 796	€ 0	€ 314

* Senior note rated A
 ** Senior Note rated A, new Mezz Note rated B and created from decreasing Sub Note in original Freedom. Decrease in overall loan value due to sales/paydowns.
 *** Senior Note rated A, Mezz Note rated B.
 **** Senior Notes consist of 700mm AAA notes (ECB eligible), 50mm AA notes, and 46mm A notes.