

Liquidation Consortium

I. Rationale

- To convene in one room senior-level representatives of major bank and investment bank counterparties of Lehman -- most notably in tri-party repo, credit-default swaps, and other OTC derivatives – who we feel would be most adversely affected by a Lehman insolvency.
- To provide a forum where these firms can explore possibilities of joint funding mechanisms that avert Lehman's insolvency.

II. Possible Consortium Members

Banks and Investment Banks with exposures from loans,
OTC derivatives, tri-party repo:

Bank of America
Barclays
Citi
Credit Suisse
Deutsche
Goldman
JPMC
Merrill
Morgan Stanley
RBS

Other affected parties

BONY
State Street

- Goal would be to invite institutions that will stay at the table. If one leaves, many more may follow

III. Logistics

- First meeting must occur, at the very latest, Friday at the close of business New York time. If we perceive that the current potential bids for Lehman are unlikely to materialize, we should move the meeting up and consider holding it on Thursday.
- Very little advance time given to participants – 2 hours max – to

minimize risk of outside leaks.

- Exception: we should immediately indicate to current and potential sole bidders for Lehman that we are planning to convene a consortium that will include them and other market participants no later than Friday.
- Invitations by phone – inviting the CEO and one other participant. Invitees are told that they should have the authority to bind their firms but are not in advance told the identity of the other firms to be represented at the table.
- FRBNY to host. Paulson delivers introductory remarks (we script) and Treasury and FR staff recede to background to provide passive mediation at most. Lawyer present to provide antitrust protections.
- Lehman senior staff (not Fuld) in a separate room, available to provide information if necessary. Lehman must also be prepared to open its books to representatives of the consortium as early as Friday night.
- Participants told by Paulson that they have until opening of business in Asia (Sunday night NY time) to explore whether they can jointly come up with a credible plan to recapitalize Lehman to an extent necessary to enable an orderly winding down. Paulson conveys willingness of the official sector to let Lehman fail.
- FRBNY starts to communicate with foreign supervisors while meeting is taking place.
- We would expect consortium members to break and reconvene for a period of up to 48 hours, in addition to sending a consortium team to Lehman for due diligence.

IV. FRBNY financial commitment (this section expected to be overhauled by Dudley, Schetzle)

- We should have in mind a maximum number of how much we are willing to finance before the meeting starts, but not divulge our willingness to do so to the consortium.
- Term of any liquidity support should be long enough to guard against a fire sale, but on a short enough fuse to encourage buyers of Lehman assets to come forward. Two months to a year in duration?
- Preferable to style FRBNY commitment as much as possible as a backstop rather than lending, but we can't attach too much of a subsidy to liquidity, or the consortium will not have sufficient incentives to act.

V. Consortium commitments

- We will put forth at the meeting how much we think Lehman needs

in terms of an infusion. We assume that members of the consortium will not pull business from Lehman going forward, which may decrease the amount of support needed.

- Consortium members will incur other costs – seconding their staff to work at Lehman starting immediately.
 - Lehman is bigger and more global than Bear Stearns, so the consortium will have to address in short order the question of how to establish control at Lehman offices outside New York.

VI. Sunday Night Statements

- Consortium will have to come up with a statement to the financial markets on Sunday night, if they can come to material agreement on a sufficient plan.
- Treasury, FR may wish to issue statements on Sunday as well. FR will want to discuss any new liquidity facility that has been created to provide a backstop to the consortium.

VII. Open Issues

- Legal
 - Approval of current Lehman shareholders – what would a takeover by the consortium require, and can it be obtained easily?
 - Regulatory approvals – what would be necessary worldwide, and with what time constraints/considerations? (Presumably FR could help facilitate.)
 - Is the consortium vulnerable to attempts by nonconsortium members to take Lehman into involuntary bankruptcy, including in jurisdictions outside of the United States?
 - Can we obtain necessary FOMC approval for whatever funding facility is fashioned to facilitate a consortium?
 - What type of capital or other regulatory relief should/must we provide for members of the consortium?
- Governance
 - Can the consortium come to sufficient agreement on how to manage Lehman, at least in the short term (next two weeks) by late Sunday afternoon? Will 2-3 firms emerge as leaders willing to shoulder the administrative burdens by, for example, seconding staff to Lehman?
 - Does Fuld have to be replaced on Sunday? If so, do we exercise influence over the choice of his successor?

- To what extent does FRBNY become involved, or mired, in disputes between the consortium members after Sunday?

- Ratings Agencies
 - When do we expect the consortium to approach the ratings agencies, and to what extent do we engage in discussions with the ratings agencies over FR liquidity we expect to provide to the consortium?
- Communications
 - Do we have any chance of keeping the initial and ongoing meetings of the consortium on Friday and over the weekend confidential? How do we get the consortium members – and Paulson – into the building without alerting the press?
 - Which foreign authorities do we inform about the initial meeting of the consortium? Are there other official bodies whom we inform before a statement is made to the public -- either inside or outside the United States?
 - What are the bare minimum elements of the Sunday night statements – by the consortium, by Lehman, by FR, by Treasury – that will provide sufficient, immediate comfort to the financial markets?
 - When and how do inform key Members of Congress?
- Financial capital
 - How do we best hone in on the monetary figure we think the consortium will have to provide in new capital and the type/maximum amount of any FR financing to support the consortium? What is the deadline for finalizing these numbers, and what further financial information do we require?
 - Does this new financial commitment put a material strain on consortium members?
 - Are current compensation commitments by Lehman (for example, bonus accruals) – which presumably survive takeover by the consortium – unduly onerous?
- Human capital
 - How can the consortium retain key Lehman staff?
- Longer-term planning
 - It is recognized that much of Lehman will disappear in relatively short order. For financial stability purposes, will we want to shorten, lengthen, or otherwise manage that process through the consortium?
 - When would we expect to wind down any FR liquidity facility that supports the consortium, and to what extent must/should we state this publicly?

