

From: Arthur Angulo/NY/FRS

Sent: Sep 10, 2008 14:35:16

To: Timothy Geithner/NY/FRS@FRS; Terrence Checki/NY/FRS@FRS; Thomas Baxter/NY/FRS@FRS; Chris McCurdy/NY/FRS@FRS; Lucinda M Brickler/NY/FRS@FRS; Jan Voigts/NY/FRS@FRS; William BRODOWS/NY/FRS@FRS; William Dudley/NY/FRS@FRS

Cc: Meg McConnell/NY/FRS@FRS; William Rutledge/NY/FRS@FRS

Bcc: Meg McConnell/NY/FRS@FRS; William Rutledge/NY/FRS@FRS

Subject: Fw: Lehman Update

Punch line: The execs reiterated, as they have in the past, that they do not want to be the first one to make that call and are mindful of the implications of such a decision. However, they did state that they do not want to be the last one to make that decision and so will be keeping close eye on (a) prime brokerage onboarding activity at JPMC, (b) activities of other major counterparties, and (c) behavior of tri-party investors.

As previously communicated if any decision along these lines is made then JPMC will place a call in advance to Fed/OCC senior management.

----- Forwarded by Arthur Angulo/NY/FRS on 09/10/2008 02:29 PM -----

Gregory Gaare/NY/FRS

09/10/2008 02:19 PM

To William Rutledge/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, Steven J Manzari/NY/FRS@FRS, Barbara Yelcich/NY/FRS@FRS

cc James DeFalco/NY/FRS@FRS, Liska Holness/NY/FRS@FRS, Edgar Moreano/NY/FRS@FRS, Erin Upton/NY/FRS@FRS, Barbara Yelcich/NY/FRS@FRS, Christopher Hunter/NY/FRS@FRS, Jennifer Tranter/NY/FRS@FRS, Jeffrey Levine/NY/FRS@FRS, Antonino Piscitello/NY/FRS@FRS, Laura Braverman/NY/FRS@FRS, Theonilla Lee-Chan/NY/FRS@FRS, Dexter Williams/NY/FRS@FRS, Steven Mirsky/NY/FRS@FRS, William Hallacy/NY/FRS@FRS

Subject Lehman Update

We participated in a call with risk executives at 1pm to discuss Lehman along with the OCC. One of the executives had just finished a presentation to senior management internally. Current exposure at the firm includes \$5 billion in primary exposure, the bulk of which is derivative counterparty and \$10.6 billion in operating exposure (see attached ppt). Committed lines are small at \$329 million and there are no drawdowns under any lines as yet.

Collateral

JPMC has secured an additional \$3 billion in o/n collateral since yesterday from Lehman and that is posted under a lien agreement they put in place with the firm. The collateral consisted of \$1bn in cash posted yesterday and \$2 billion in JPMC money market fund investments that Lehman has made. Today Lehman asked to substitute in some securities and JPMC risk executives are considering it. JPMC was concerned about not being in a position to meet calls on behalf of Lehman and so requested the additional coverage. Lehman met that request in addition to covering roughly \$500mm in collateral disputes outstanding. To the extent JPMC determines the disputes are not warranted they may return collateral to Lehman but for now Lehman agreed to cover them.

3rd party haircuts are up substantially although no more details were offered other than confirmation one large investor has doubled their haircuts (8% to 16/20%). If tri-party investors increase haircuts its will force Lehman to reduce the

size of its book.

Rating Agencies

Risk executives remain very concerned about rating agency actions. A one notch downgrade would require Lehman to post an additional \$2 billion in collateral (Lehman's estimate) and a two notch downgrade approximately \$5 billion in collateral across all counterparties. Under a downgrade scenario JPMC feels client activity will change dramatically for Lehman and they requested additional collateral to cover that possible event. They are concerned that the rating agencies, particularly S&P, are ready to act and may not be satisfied by the proposed asset sales and real estate spin. The current plan was also put forth to the rating agencies before the huge drop in market cap and so with that now facing the firm, JPMC risk execs believe the rating agencies will need to revisit their assessments.

Derivatives

Novation activity has picked up on Lehman throughout the day but it is still too early to determine if the underlying exposures are sizable. JPMC gets automated novation requests in a mailbox and until they are processed overnight the executives will not have a sense of size related to the requests. JPMC is very sensitive to other firms attempting to move entire derivative books over without telling JPMC upfront and so JPMC may reserve the right to decline the novation requests if they feel that is the case.

Market Response

JPMC risk executives were surprised at the somewhat muted response to Lehman's disclosures. They have a more severe outlook for the firm and believe that a suitor is required over and above any asset management sale and/or real estate spin off if the firm is going to survive as a going concern. In fact they were surprised the market is giving them credit for sale of the asset management business when nothing has been finalized. Risk executives were also concerned that \$2 billion of the gains were on liabilities and those will need to be reversed over time thus ""bleeding"" into the P&L picture in the months ahead.

Based on the stock price and CDS spreads risk executives at JPMC believe the cost of capital for Lehman to recapitalize is extremely high and dilutive to the current equity holders.

JPMC's course of action

We questioned the risk executives to see if senior management has put forth any triggers or course of events that would signal a desire by JPMC to stop trading, cut lines, and run from Lehman. The execs reiterated, as they have in the past, that they do not want to be the first one to make that call and are mindful of the implications of such a decision. However, they did state that they do not want to be the last one to make that decision and so will be keeping close eye on (a) prime brokerage onboarding activity at JPMC, (b) activities of other major counterparties, and (c) behavior of tri-party investors.

As previously communicated if any decision along these lines is made then JPMC will place a call in advance to Fed/OCC senior management.