Confidential

Lehman Brothers ABS CDO Exposure

November 1, 2007

LEHMAN BROTHERS

Lehman ABS CDO 2007

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The two key reasons Lehman Brothers has successfully navigated the difficult ABS environment of 2007:

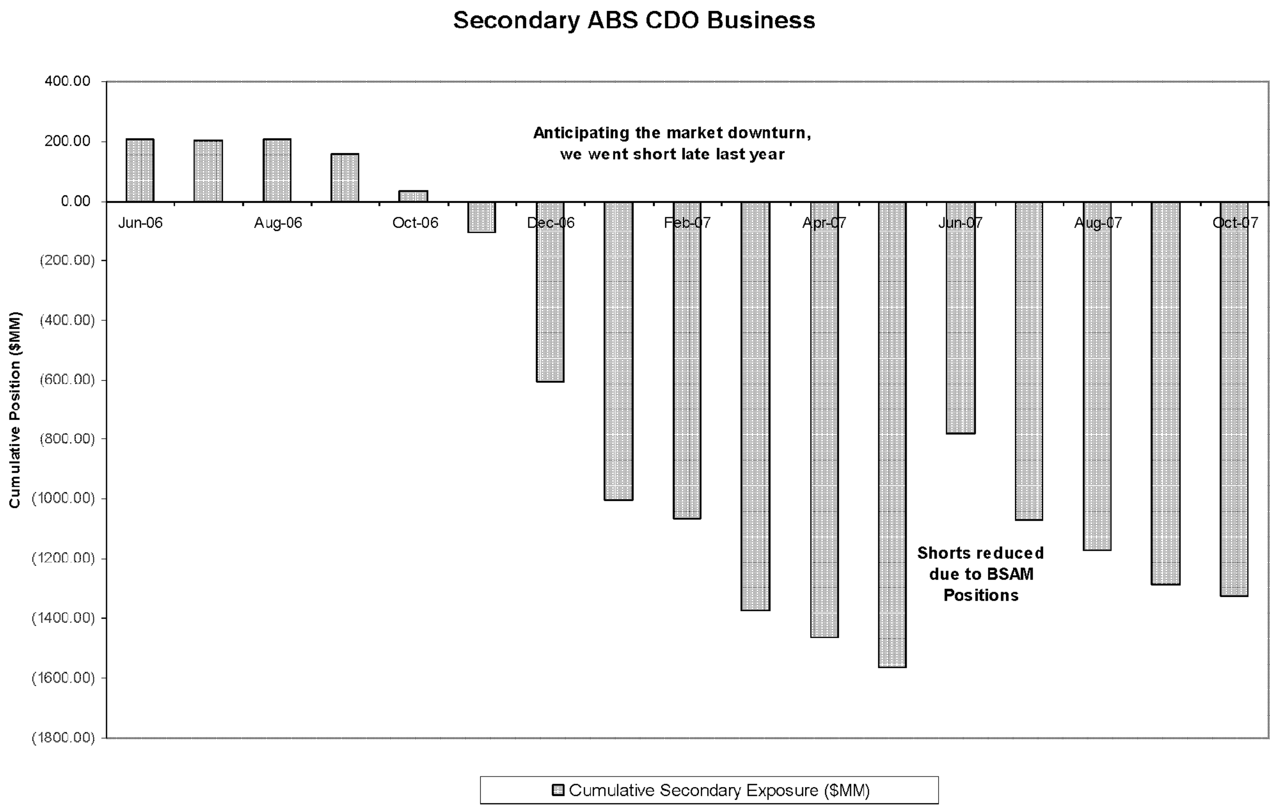
Risk Management:
We have had substantial short positions across the capital structure within HG and Mezz ABS and ABS CDO collateral since Q406. Although we have had substantial "basis" risk between underlying deals and hedges, within ABS CDO's *we have been net short the market throughout 2007.*

Distribute / not Retain Model:
We have (consciously) been a smaller player in the ABS CDO market as our model *has been to distribute – and therefore not retain - all parts of the capital structure.* This model by design creates fewer transactions as we were unwilling to retain "hurdle" or difficult to move classes.

Key Operating Tenet - Risk Management of ABS CDO

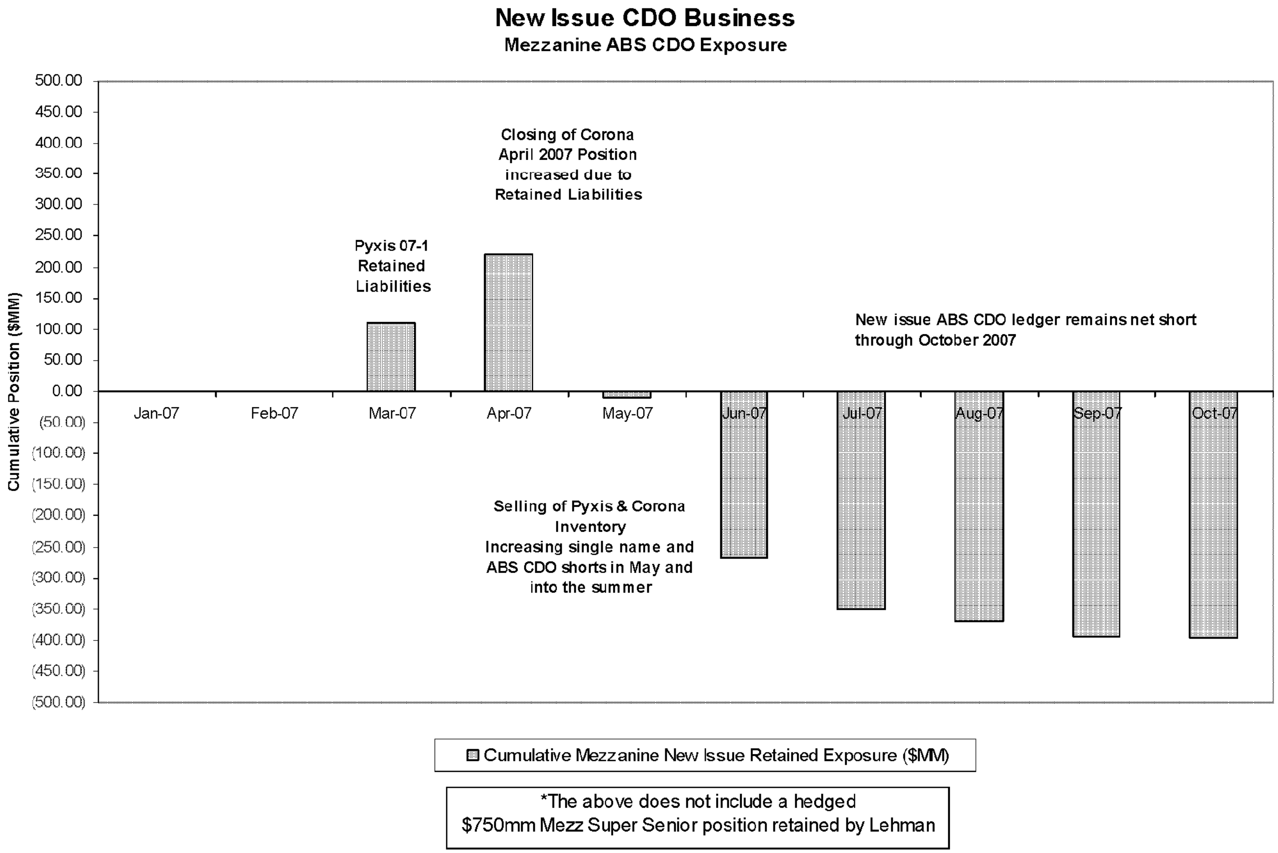
Lehman ABS CDO 2007 – Risk Management

Our ABS CDO desk, headed by Charlie Spero, became concerned in late 2006 about excessive valuations in ABS CDOs and began shorting individual tranches across Mezzanine ABS CDOs and single name HELs.



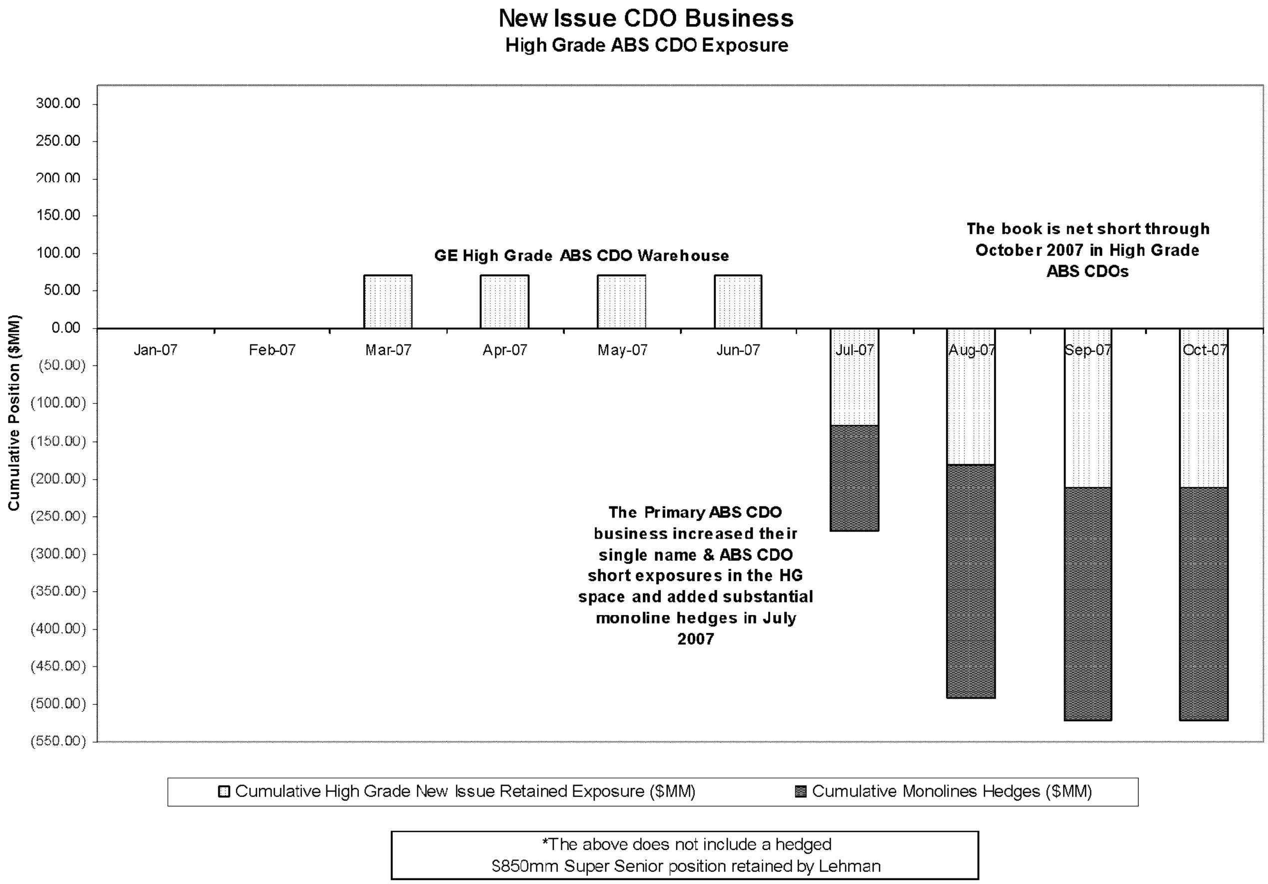
Lehman ABS CDO 2007 – Risk Management

In 2007, as the market continued to deteriorate, we increased our shorts in this sector within the New Issue business as well, to both profit from the opportunity and to hedge the remainder of our 2007 primary pipeline.



Lehman ABS CDO 2007 – Risk Management

We followed a similar hedging strategy in the High Grade ABS CDO space, shorting individual tranches of ABS CDOs and ABS single names throughout 2007. Further, we put on substantial hedges to minimize exposures to the monolines and mitigate counterparty risk in our retained Super Senior positions.



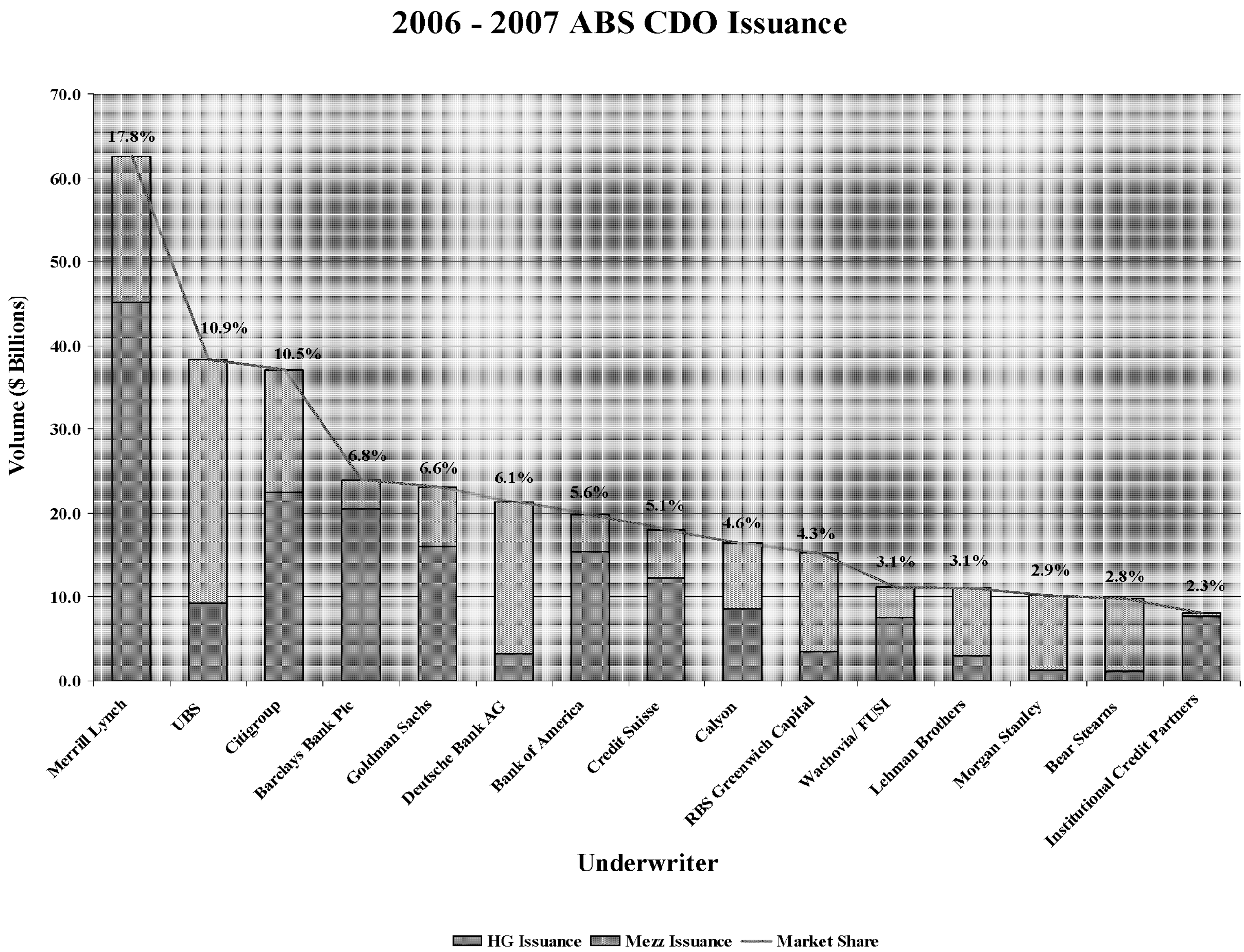
Key Operating Tenet – Distribute not Retain

Lehman ABS CDO 2007 – Distribute Not Retain

Lehman has made a conscious effort to be a smaller participant in the ABS CDO space, despite our prominence in the broader ABS markets.
Our operating principles in the primary ABS CDO market are:

- Work with top-tier managers only – whose liabilities are the most marketable to investors
- Work with a manageable pipeline to minimize retained interests in transactions
  - This is antithetical to, for example the MER model of pipeline "stuffing" to maximize origination revenue, as this can have the adverse affect of retaining too many assets on balance sheet
- Leveraging our best in class distribution model to move – not warehouse – risk
- Create securities whose underlying collateral is of the highest value, ensuring the securitization's value is also maximized
- ***Our 2006-2007 ABS CDO issuance totaled $11bln, a 3% market share***

Lehman ABS CDO 2007 – Distribute Not Retain



Better structures make for easier to distribute risk – Mezzanine ABS CDOs – 2007 Origination

Lehman's Mezzanine ABS CDO origination has moderate inclusion of ABS CDOs within the asset pool and has focused on higher Super Senior attachment points versus our competitors.

MERRILL ORIGINATION

- **Norma CDO I**

  $1,500mm Mezzanine ABS CDO

  Manager: NIR Capital Management LLC

  Priced: January 2007

  Super Senior Attachment Point: 35%

  CDO Bucket: 10%, BBB weighted average rating

  – 57.29% MER Origination

  – 32.75% CDS form, assume MER is Counterparty

  – 9.96% Other Origination in Cash form

  – 12 Distinct positions, chunkier position size

  As of early October 2007, this deal was failing all OC triggers

  The impact of the mid October downgrades will further impair this transaction

LEHMAN ORIGINATION

- **Corona Borealis CDO Ltd**

  $1,500mm Mezzanine ABS CDO

  Manager: New York Life Investment Management

  Priced: March 2007

  Super Senior Attachment Point: 50%

  CDO Bucket: 5%, AA weighted average rating

  – 21.43% MER Origination

  – 11.43% LEH Origination

  – 14 Distinct positions, very diverse

  As of September 2007, this deal was in compliance with its OC triggers

  However the impact of the October downgrades are expected to impair this transaction

Better structures make for easier to distribute risk – High Grade ABS CDOs – 2007 Origination

Lehman's High Grade ABS CDO origination has minimal inclusion of ABS CDOs within the asset pool and has focused on static deals with higher quality RMBS collateral.

MERRILL ORIGINATION

- **Forge 2007-1**

  $1,500mm High Grade ABS CDO

  Manager: Forge ABS LLC

  Priced: March 2007

  Super Senior Attachment Point: 40%

  CDO Bucket: 35%, AA weighted average rating

  – 85% MER Origination

  – 8.44% CDS form, assume MER is Counterparty

  – 6.44% Other Origination in Cash form

  As of September 2007, this deal was in compliance with its OC triggers

  The impact of the mid October downgrades are expected to dramatically impair this transaction

LEHMAN ORIGINATION

- **Ceago ABS CDO Ltd**

  $1,000mm Static High Grade ABS CDO

  Manager: Lehman Brothers Asset Management

  Priced: August 2007

  Super Senior Attachment Point: 15%

  CDO Bucket: 4.1%, AA weighted average rating

  – Majority (75%) 2005 transactions

  – 25% LEH Origination

  As of September 2007, this deal was in compliance with its OC triggers

  However the impact of the October downgrades are expected to impair this transaction

Market Landscape and Environment

ABS CDO Market Landscape 2007

2007 began strongly in January with expectations of record ABS CDO issuance and investors eager to participate in the market. However the tide began to turn as early as mid-February as dealers saw interest wane in the sector and tightened their warehouse lines for collateral.

February 15, 2007	◆ Lehman priced Pyxis 2007-1 (Managed by Putnam) ◆ Due to the start of Dealer warehouse restrictions, we retain AAs & As from this deal
March 2007	◆ Lehman commences marketing of Corona Borealis (Managed by NYLIM) ◆ Difficult process, much pushback on collateral criteria, super senior attachment & spreads ◆ Lehman brings in IKB, a key investor to the deal and places the equity with both Zais & Carlyle ◆ ACA provides protection on the super senior, at wider levels from a month ago (43 vs 18)
Late Spring	◆ Lehman is engaged to bring Fidelity's first ABS CDO, Ballyrock, to market ◆ Marketing commenced in December 2006 and equity marketing is ongoing during this time ◆ Debt marketing begins in earnest in May ◆ Difficulty convincing Fidelity that coupon levels are at the recent wides, despite their presence in the Fixed Income markets ◆ Fidelity prices on June 12, 2007, Lehman is retaining much of the lower tranches
July 2007	◆ Rating agencies begin the RMBS collateral downgrade shortly after July 4^{th} ◆ Ballyrock is caught with downgraded collateral, 2 days prior to closing ◆ Decision is made to remove DG'd bonds, complete the ramp-up and go effective on July 12^{th} ◆ Lehman is able to source much of the collateral for the remainder of the Ballyrock pool, as directed by Fidelity

ABS CDO Market Landscape 2007

By late summer 2007 the effects of BSAM, shrinking of liquidity and overall freeze on the ABS & ABS CDO markets was apparent. The Fall did not bring about an end to the turmoil and spillover into the broader credit markets is seen.

Late July 2007

- Lehman feels out the market by introducing a conservative HG ABS CDO in July 2007
- LBAM, viewed highly by investors is the collateral selector and will monitor the deal going forward
- In an effort to be ultra conservative and solicit investor interest, Leh & LBAM agree to a static deal, no reinvestments to the pool, a minimal CDO bucket and minimal second liens
- Leh is able to convince XL to write protection on the deal, albeit at a wider spread and with much debate over the collateral in the pool

Post Labor Day

- August has the market waiting for a "Labor Day" bump which does not occur
- The SIV and Conduit markets experience much turbulence as CP issuance comes to a standstill and transactions begin to hit Market Value triggers causing much concern and "press" in the sector
- The Fed reduces rates by 50bps, while helpful, not enough to stop the downward spiral

Fall 2007

- Some normalcy comes back into the ABS CDO market in early October as potential new participants inquire about opportunities and many institutions announce their plans for "distressed opportunity funds" in the ABS & ABS CDO space
- This is short lived however as Moody's onslaught of downgrades on October 11th again throws the market into a tailspin.
- The impact of these downgrades is dramatic, causing the majority of 2006 & 2007 issued ABS CDOs to fail triggers and come precariously close to EODs

ABS CDO Market Landscape 2007

The liquidity crunch, the escalating poor performance of the underlying collateral and the resulting rating agency downgrades culminate into the “Perfect Storm” this October.

Downgrade Impact	◆ Much emphasis placed on impact of an Event of Default in an ABS CDO ◆ Waterfall impacts could shut off much of the capital structure from either principal or interest payments ◆ Realization that each deal varies on this topic and the language is vague
Long October	◆ October month-end valuations will reflect the impairment and much of the sector will be priced at IO values ◆ Moody’s began its review and downgrades of the ABS CDO sector, which will have further ripple effect impact on investors – whether they are an ABS CDO, or a firm that is ratings sensitive ◆ Expect many forced sellers with little to no liquidity
Write-downs	◆ The Banks announce their write downs due to impairment in the sector ◆ Merrill announces biggest loss, however as this would reflect only the impact prior to the extensive downgrades, this number should grow substantially if current conditions are sustained for the remainder of 2007

The Overall ABS CDO Market Outstanding is About $525 Billion …

The Universe is Equally Split Between HG and Mezz Deals

ABS CDO Outstanding across Vintages

	Deal Type			
Vintage	HG	Mezz	CDO^2	Total
<=2004	41	31	5	78
2005	61	35	2	98
2006	110	97	12	219
1H07	36	68	6	110
2H07+ Pipeline	5	9	1	15
Total Outstanding	253	241	26	520

Source: Lehman Brothers, IFR Markets

… And the Credit Issues Have Resulted in Mark-to-Market Losses of about $175bn on CDO Liabilities

Overall HG and Mezz NAVs are 80% and 60% Respectively

CDO Mark-to-Market Loss by Vintage, $bn

	HG CDOs			Mezzanine CDOs		
Vintage	Outst, $bn	NAV	Loss, $bn	Outst, $bn	NAV	Loss, $bn
<=2004	41	91.1	3.6	31	84.4	4.9
1H05	19	89.0	2.0	14	76.6	3.2
2H05	42	86.6	5.6	21	67.9	6.9
1H06	42	72.7	11.6	30	43.7	16.7
2H06	67	68.8	20.9	67	34.7	44.1
1H07	36	67.1	8.1	68	39.6	28.2
Total	253		52.0	241		103.9

Shows mark to market losses on HG and Mezz CDOs. The table above does not account for about $25 billion losses from CDO^2.

Financial Guarantors and Insurance Companies Hold a Majority of AAA Risk …

More to Come In Terms of Mark-to-Market Losses

Holders of Risk	Exposure ($bn)	Sensitivity Factors
Financial Guarantors	100	MTM, May post capital on asset/company D/G
Insurance Companies	85	MTM, May post capital on asset/company D/G
CDO CP Put Providers	60	Provide 100% liquidity if CP is not rolled
ABCP Conduits	30	Not MTM, D/G assets bought out at par
SIVs	15	Sensitive to severe MTM, potential liquidations
Other CDOs	12	Not MTM, cashflows sensitive to sub-IG D/Gs
Total Accounted	302	
Unaccounted	154	Held by dealers, banks, foreign accounts, etc.

… While Only About Half of Subordinate CDO Risk Sits With End Investors

HG CDOs Hold about 30% to 40% of Subordinate CDO Risk

	End Holders of CDO Liabilities				
Rating	Outstanding	ABS HG	ABS Mezz	CDO^2	End Investors
AA	30.6	14.9	0.7	0.9	14.2
A	15.6	5.0	0.9	2.0	7.8
BBB	17.2	0.3	4.7	2.4	9.9
Total	63.5	20.1	6.3	5.4	31.7

Competitor Notes

- Merrill Lynch's ABS CDO volume for 2007 is approximately $30bln YTD and their 2006-2007 YTD issuance across both High Grade and Mezzanine deals is approximately $62bln, an 18% market share.
- MER has been known to bring deals for a plethora of managers ranging from "2 Guys & a Bloomberg" to prolific issuers such as TCW & GSC
- As such, MER created an origination machine with many managers in their stable and an abundance of open warehouses & transactions where they could distribute their pipeline
- Many of these managers' entire business model is ABS CDO management and as such their success & viability is driven by issuance. Examples include: NIR Capital Management, LLC; Harding Advisors, Forge ABS LLC and Maxim Capital Management LLC
- Without a broader platform, many ABS CDO managers relied on their dealers for warehouse financing and to find the equity necessary to bring a transaction to market
- Many of these smaller participants were likely beholden to MER originated CDOs for their transactions, especially as the market began to show early signs of stress in February 2007