

LEHMAN BROTHERS | Equities

Risk Appreciation



The Lehman Brothers Risk Culture

"When we talk about risk management, it's not just about market risk and credit risk; it's also about reputational risk, people risk, client risk and corporate governance. It's about who we are, it's about branding — it's about everything we do each day. We watch all of these risks very closely, making it a mission-critical priority to practice active and intelligent risk management at every level of the Firm. We rely on all employees to think before they act. This vigilance works because we treat everyone as a risk manager, guarding against inappropriate risk."

- Dick Fuld, Chairman and CEO (Lehman Brothers Quarterly, Fall/Autumn 2006)

Fostering A Culture of Risk Appreciation

- ❑ What is Risk Appreciation?
- ❑ How Does a Culture of Risk Appreciation Help the Firm Increase Revenues?
- ❑ How do We Foster Such a Culture?
- ❑ What is the Risk Appreciation Task Force?

Risk Appreciation Tools

Equities Senior Management is sponsoring the development of the following tools to help the Sales force undertake more effective risk management:

- ❑ LPM Competency — at mid-year and year-end, each Sales professional will be evaluated against a new Risk Appreciation competency.
- ❑ Net Client Revenue — models are being developed to appropriately represent Risk Appreciation when calculating client revenue.
- ❑ Risk Appreciation Quarterly — this newsletter will showcase current topics and initiatives in Risk Appreciation.
- ❑ Training — a Risk Appreciation module is being developed in partnership with Lehman University.

Distressed Counterparties

Distressed counterparties present a multitude of risks including possible litigation. You should be aware of the types of behavior that may indicate a counterparty is in need of closer scrutiny. If you observe suspicious client behavior, you should keep the information confidential and report it directly to your manager.

- [Click here for the Q1 2008 Risk Appreciation Quarterly](#)
- [Click here for the Q1 Risk Appreciation Survey](#)
- [Click here for the internal MiF website](#)
- [Click here for the approval pc Algorithmic, Research-driven Lehman Brothers-sponsored Strategies](#)

Risk Appreciation Task Force

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Click [here](#) for a list of potential warning signs.

Lehman Performance Management (LPM)

A Risk Appreciation competency has been included for the Equities Sales force. Each Sales professional will be reviewed and evaluated on this new competency at mid-year and year-end.

The new competency consists of the following criteria:

- **Awareness:** understands and appreciates the market, credit, legal and operational risks inherent in transactions.
- **Communication:** shares relevant information and proactively highlights key risks to partners in Trading and Control areas; highlights examples of good risk appreciation and disseminates best practices.
- **Client Skills:** negotiates transaction terms for optimum risk-reward profile; declining unfavorable transactions while working to preserve strong client relationships and ensuring they understand their true impact on the LEH P&L.
- **Shareholder/Manager Behavior:** deploys capital efficiently and in consideration of clients' historical trading impact and seeks to offset traders' positions; takes "ownership" of the risks as well as the rewards of transactions.

Click [here](#) to see a screen-shot of the 2007 LPM page.

Net Client Revenue (NCR)

Revised Net Client Revenue models are currently being developed to better measure the risk and revenue associated with each transaction in order to more accurately assess the contribution of Equities Sales. A significant enhancement to the current methodology is the shift from ex poste theoretical models to ex ante expected models, i.e. models that predict the expected outcome at the time the trade is initially executed. New Net Client Revenue models are expected to be finalized and implemented by Fall 2007.

Click [here](#) to view the latest Net Client Revenue models.

Risk Appreciation Quarterly

The Risk Appreciation Quarterly will showcase current topics and initiatives to assist managers in facilitating risk appreciation dialogues. In addition, the Risk Appreciation Quarterly will highlight compliance and legal topics that relate to risk.

The following are recent Headlines from the Risk Appreciation Quarterly:

- BusinessWeek Article on Risk Management
- Wall Street Journal Article on Reg NMS
- Wall Street Technology Article on Instant Messaging

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Policies and Procedures

- Compliance and Regulation
- Corporate Advisory
- Transaction Management
- Client Onboarding
- CreditLimits
- Algorithmic, Research-Driven
Lehman-Sponsored Index Ap
Policy
- New Product Committee
- Global Principles Applicable to
Structured Investments
- Know Your Customer/Suitability
Policies and Procedures

References

- Global Equities Sales Management
Offsite - Risk Appreciation (Ajay
March 2006)
- Risk Appreciation - A Sales Perspective
(Adam Green, Anthony Lombardi
Peel, September 2006)
- Net Revenue Models for Equity
(July 2007)
- Internal Use Only Communication
Reminder

Training Program

Risk Appreciation Training is currently under development in partnership with Lehman University. This training is intended to empower the Sales force with the tools needed to accomplish the broader Risk Appreciation mandate.

The training format is envisioned as follows:

- **Participants:** All Equities Sales Employees
- **Moderator:** Leadership and Learning
- **Frequency:** Quarterly
- **Launch:** Spring 2008
- **Format:** Modeled after Ethics seminar, e.g., primarily taught by the case method

[Click here to view a sample case study](#)

Operational Risk and Resources

The Sales Force is responsible for minimizing transaction and counterparty risks from the first step of client on-boarding to post-trade analytics. The Risk Appreciation Task Force is committed to educating the Sales Force on ways to limit exposure to Operational Risks.

Client On-Boarding

The Sales Force is responsible for client verification when on-boarding a new client to the Firm. This is essential for minimizing counterparty risk. The Equities Client On-Boarding team was established to assist the Sales Force in the efficient coordination of the account verification process, including Anti-Money Laundering, Know Your Customer procedures and transaction documentation such as ISDA agreements. You can find out more about how to leverage this valuable resource via LehmanLive keyword: [EQCOB](#), or by contacting [Erica Smoller Benjamin](#).

Confirmations

Outstanding confirmations expose the Firm to counterparty risk and are a focus of regulators. All counterparties are required to sign trade confirmations promptly following the execution of derivatives transactions. In order to ensure prompt execution of confirmations, trading should occur only where document templates have been agreed upon with the counterparty. Failure to promptly execute confirmations could result in counterparties being restricted from entering into future transactions. Sales people can find out more about the Transaction Management Group (TMG) and mitigating transaction-specific legal and documentation risk at LehmanLive keyword: [TMG](#) or by contacting [Rob Guglielmo](#) or [Anatoly Kozlov](#).

Client Valuations

In accordance with Lehman Compliance policy, the Sales Force is not allowed to deliver security valuations to clients. Delivering inaccurate valuations creates risk and can result in litigation. The Client Valuations Group (CVG) was created to provide the necessary support and control for pricing and valuations that are sent to clients. This initiative is underway across all equity products. Please [e-mail](#) the Client Valuations Group to coordinate any valuation requests.

- Potential Early Warning Signs of Counterparty Distress
- Building a Culture of Risk Appre (Adam Green, Anthony Lombard Peel, May 2007)
- Sales Management, Risk Appre Action Steps

Archive

- Risk Appreciation Quarterly, Q1
- Risk Appreciation Quarterly, Q2
- Risk Appreciation Quarterly, Q3
- Risk Appreciation Quarterly, Q1

Credit Approval Policy

The Sales Force is responsible for obtaining approval for credit risk when transacting with counterparties. Credit-sensitive transactions are authorized by Credit Risk Management (CRM), either through pre-approved counterparty limits and trade types, or on a trade-by-trade basis. Counterparty credit limits are available via LehmanLive, keyword: **CreditLimits**. Access to the credit limit sets is authorized via TAC and training can be provided by contacting one of the credit analysts listed in the CRM contact section on the site. The site is a valuable resource providing additional transparency around the existing approval process, specific counterparty exposure limits and CRM contact information.

MiFID

The Markets in Financial Instruments Directive (MiFID) became effective as of November 1st, 2007. MiFID, which replaces the Investment Services Directive of 1993, is the cornerstone of a larger plan to integrate financial trading and intermediation in the European Union, and is the biggest change ever in the structure of a major financial market. In short, MiFID is intended to transform the European Union into a single entity from a regulatory perspective. While the focus (particularly in the press) has been on Equities trading, MiFID covers all products, and brings more transactions under the umbrella of a single regulatory oversight. For more information, visit LehmanLive, keyword: **MiFID** for the internal MiFID website. Also, click [here](#) for a MiFID training webcast.