

Time held: start 7:00 am – approximately 8:45 am

Participants:

Xavier Oustalnier – Managing Director, Alvarez & Marsal

Al Lakhani - Managing Director, Alvarez & Marsal

Gani Bardhi – Senior Associate, Alvarez & Marsal

Frank Lazzara – Director, FTI Consulting

James Hraska – Senior Vice President, Lehman Brothers Inc. / Barclays Capital

Nancy Denig – Vice President, Lehman Brothers Inc. / Barclays Capital

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Friday, 9/12/08

1. Per Nancy Denig, the total balance of collateral pledged under the tri-party repo between Lehman, JPM and the Fed on Friday, September 12<sup>th</sup> was “much less than the \$49.3B balance as of Monday, September 15<sup>th</sup>”; however it was not \$0.

Monday, 9/15/08

2. Three transactions from Fed funding sources, a TSLF loan, an OMO and a PDCF, started on the 15<sup>th</sup> to make up a \$49.3B balance<sup>1</sup>.
  - a. TSLF<sup>2</sup> – which is comprised of two schedules:
    - i. TSLF Schedule 2 9/15 balance of \$10.8B
    - ii. TSLF Schedule 1 9/15 balance of \$7.7B
  - b. OMO<sup>3</sup> with FED 9/15 balance of \$2.8B
  - c. PDCF<sup>4</sup> (Discount Window) 9/15 balance of \$28B
3. TSLF Schedule 2 is comprised of asset backed, esoteric securities.
4. TSLF Schedule 1 is comprised of government securities.
5. Lehman TSLF started using the Fed TSLF loan in March 2008 and the balance increased slowly up through September 18<sup>th</sup>.
6. OMO was traded every night with the FED. The balance stayed constant every day.
7. Lehman did not start using the PDCF as there was no need, until September 15<sup>th</sup>. It was tested on March 17<sup>th</sup>.
8. The marks are based on commercially based prices that are fed into Lehman’s GFS system. They are not JPM prices per se, because they are received from third party vendors.
9. The initial processing of the trade is based on the adequacy of the collateral in terms of its principal value, and not its market value. The principal value being assessed is already reduced for the agreed upon haircuts. The amount of the haircut within the principal value is not clearly stated, however it can be derived based upon the information presented. When backed into, the haircut may not be 100% accurate because GFS reflects the pricing from the vendors.
10. TSLF and the Discount Window (PDCF) are valued by JPM, not Lehman. OMO is not JPM pricing.
11. Once the securities to be used for collateral are allocated to the repo, the trade is recorded.

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<sup>1</sup> Source: Document titled Fed Programs-9.15-9.17.xls, tab 1 sent by Nancy Denig and received on 10/08/08. The source of the data in this document is Lehman’s internal MTS settlement system.

<sup>2</sup> TSLF is an acronym for the Term Securities Lending Facility at the Federal Reserve.

<sup>3</sup> OMO is an acronym for Open Market Operations with the Federal Reserve.

<sup>4</sup> PDCF is an acronym for the Federal Reserve’s Prime Dealer Credit Facility.

Tuesday, 9/16/08

12. Three transactions from Fed funding sources, a TSLF loan, an OMO and a PDCF, created a \$40.7B<sup>5</sup> balance on Tuesday, 9/16/08.
  - a. TSLF:
    - i. TSLF Schedule 2 9/16 balance of \$11B
    - ii. TSLF Schedule 1 9/16 balance of \$7.8B
  - b. OMO with FED 9/16 balance of \$2.2B
  - c. PDCF (Discount Window) 9/16 balance of \$19.7B

Pricing

13. MTS is Lehman's settlement system. Market prices are fed to that system from the JPM (i.e. obtained from a third party) and Lehman feeds.
14. GFS is a P&L aggregator that receives a feed from all settlement systems, including, but not limited to, MTS. GFS in turn feeds the MTS subledger. GFS includes a detailed breakdown of the collateral pledged.
15. The Lehman Treasury Department determines the liquidity needs that Lehman, as a whole, needs in order to operate. The trading desk executes the strategy. The overnight repo desk makes the deals with the FED. The two points of contact on this are *Dan Fleming* who is on the cash management side, and *John Feraca* who is on the liquidity side. *Larry Servidio* works under *John Feraca* and he is the actual trader that places the order with the FED and books the shell<sup>6</sup> that gets sent down to JPM.
16. The measurement of the adequacy of collateral value occurs at the end of the business day, but not intraday.
17. The collateral in support of OMO overnight trades are monitored intraday. The collateral sourcing can change, but the principal amount of the overnight repo transaction remains constant. The changing of the sourcing of the collateral is done by Lehman. TSLF is monitored, and if needed, loans are allocated additional collateral. PDCF is addressed, if necessary, after that.
18. *Mr. Lakhani* questions what happens if Lehman is short on collateral. *Mr. Hraska* explains that with these 3 programs, Lehman will not short, as JPM will determine the amount of collateral necessary to support the repo transactions and will assign it as an additional pledged asset, if necessary.
19. On 9/18, Lehman was short in that they no longer possessed collateral that qualified for the repo program. Accordingly, JPM arranged for a \$7B "box loan", which essentially is a loan against the remaining securities held in custody by JPM, not in accordance with tri-party repo agreements outstanding at that point in time.
20. MTS should have haircuts that JPM accepts; *Ricky Policke* should have a file showing this. *Ricky Policke* handles MTS from the technical side, uploads pricing files to MTS and performs a daily reconciliation.

Discrepancies in collateral value

21. *Xavier Oustalniol* asks how much does JPM think that Lehman needs to be over collateralized. *Nancy Denig* responds that JPM "has their arguments." Generally, a discussion over collateral needs takes place starting at 2:00 pm, through the end of the day.
22. If there is a discrepancy, Lehman's tri-party manager talks to JPM's tri-party manager.

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<sup>5</sup> Source: Document titled Fed Programs-9.15-9.17.xls, tab 2 sent by Nancy Denig and received on 10/08/08.

<sup>6</sup> The "shell" is the funding request that Lehman places an order for loans in their trading systems.

23. If there is a disagreement between JPM and Lehman as to collateral pricing, after haircuts are applied, JPM would refer to Bloomberg and obtain other prices.
24. Pricing source issues occurred frequently with MBS. These discrepancies could be attributable to the classification of the security.
25. There were major scrubbing efforts between Lehman and JPM to make sure the right collateral was going into the shells.
26. After these efforts, if there still was a discrepancy it would be resolved within the same day.
27. There are 2 marks, a Lehman one and a JPM one. *Nancy Denig* states that “there was no reconciliation though” (between the Lehman marks and the JPM marks).
28. Effectively, JPM dictates pricing and if you want them to change their marks you need to present convincing arguments. This change is driven by JPM and their third party pricing source.
29. If JPM eventually does not agree with Lehman’s arguments then they need to give JPM more collateral; the transaction doesn’t close until both parties agree on the pricing of the underlying collateral. Deals are complete usually around 6:00 pm on any given day.
30. On Thursday, September 18<sup>th</sup> the Lehman team stayed at the offices very late, some until the morning, and the Fed and DTC stayed open until 11:00 pm, which was unprecedented. On the nights of September 15<sup>th</sup>-17<sup>th</sup> the Lehman teams did not have to stay as late relative to September 18<sup>th</sup>.

#### Deal Movement

31. STP – Straight Through Processing – Lehman’s shell moves straight to JPM. It feeds their system, but Lehman can view it by logging into the system.
32. The collateral allocated to the loan can also be hand allocated. *Mr. Hraska* notes that the hand allocation of collateral is performed by *John Palchynsky’s* team at Lehman.
33. TSLF and PDCF are tri-party allocated, but only these two. (Not OMO)

#### “Fed Programs-9.15-9.17” Spreadsheets

34. The screens are from MTS settlement system, they are a back-end system and feed into JPM’s system BDAS.
35. This process (tri-party repo collateral allocation) is managed by *John Palchynsky*.
36. MTS and BDAS are primarily used to see if the collateral value of the loan is sufficient.
37. *Dan Fleming* and *John Palchynsky’s* team are at Lehman to make sure the trade goes through with respect to collateral adequacy.
38. The tri-party custodian ultimately determines the value of the collateral. If there is a short within the tri-party program, the custodian will not reach outside of the collateral identified as supporting the tri-party program. Similarly, collateral shortfalls occurring within other divisions or programs Lehman may be participating in, cannot reach within the collateral participating in the tri-party program.
39. The Lehman systems evidence the recording of a trade in a manner as represented in the “Fed Programs-9.15-9.17” spreadsheet. This spreadsheet shows the individual CUSIPs that make up the shell.

#### Wednesday, 9/17/08

40. Three transactions from Fed funding sources, a TSLF loan, an OMO and a PDCF, created a \$41.8B balance<sup>7</sup> on Wednesday 9/17/08.
  - a. TSLF:

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<sup>7</sup> Source: Document titled Fed Programs-9.15-9.17.xls, tab 3 sent by Nancy Denig and received on 10/08/08.

- i. TSLF Schedule 2 9/17 balance of \$11B
- ii. TSLF Schedule 1 9/17 balance of \$7.8B
- b. OMO with FED 9/17 balance of \$2.7B
- c. PDCF (Discount Window) 9/17 balance of \$20.4B

41. On the same day there was a tri-party repo of \$15.8B.<sup>8</sup>
42. The repo for \$15.8B was not part of the sale of Lehman to Barclays, Barclays was a customer on JPM platform.
43. The repo with Barclays was entered into on or about 9/12/08. It slowly increased on 9/15/08 to \$2B and eventually reached \$15.8B on the 9/17/08.
44. *Dan Fleming* can confirm if and when the \$4B box loan with JPM originated.
45. When the \$15.8B repo from Barclays did not get renewed, the assets in the program went back in Lehman's free box.

#### Thursday, 9/18/08

46. On Thursday the 18<sup>th</sup>, there is \$45B market value of collateral that is moved from JPM to BoNY, for the benefit of Barclays; with \$42B in principal.
47. The loan collateral was marked at approximately \$44B by JPM. Barclays marked the collateral in accordance with BoNY's marks at approximately \$42B. BoNY is Barclays tri-party agent.
48. Barclays sent JPM \$49.6B in a tri-party repo loan with Lehman.
49. At the end of the day, Lehman only came up with \$42B in collateral (\$41.8 came from the FED). The fair market value (i.e. nonhaircut) was roughly \$45B.
50. This is represented in a file from MTS – *Ricky Policke* would have this.
51. The shell, on JPM's BDAS system, is marked at \$41.8B.
52. There were two collateral movement parts to the deal:
  - a) One part was FED deliverable collateral marked at \$28B.
  - b) The second part was DTC collateral marked at \$15B.
53. The first part was sent to BoNY in connection with a direct repo loan, not a tri-party repo loan. It was the transfer of collateral between custodians.
54. The collateral for the Barclays repo ultimately made it to BoNY, but not in accordance with the standard tri-party repo.
55. A distinction has to be made that the collateral was delivered to BoNY, then the Barclays cash was paid to JPM on behalf of the Fed. Effectively the Fed was put into a tri-party repo where the counter party was Barclays instead of Lehman.
56. It was a tri-party repo on Barclays' books, not on Lehman's.
57. The trade with Barclays was an atypical tri-party repo. It was not mechanical because collateral was pledged.
58. This can be done under the MRA contract because it was a repo transaction since, 1) the method of delivery was for the FED and 2) the trade utilized DTC tri-party mechanics; it was pledged to a custodian.
59. JPM still has control of the collateral. To move the process along Barclays was going to send in \$5B increments at a time to get JPM to release the collateral.
60. There were two problems with this setup:
  - a) There was miscommunication between Lehman and JPM. Lehman instructed JPM to not be specific on the Cusips and to immediately give the \$5B. JPM adhered to the instructions, which resulted in some of the collateral not being eligible in the FED

<sup>8</sup> Source: Document titled GFS\_84298342466355.xls, tab 3 sent by Nancy Denig and received on 10/08/08.

program (i.e. were streetside). Initially Barclays only had \$1.5B of the collateral securing the repo as the remaining \$3.5B had DTC obligations and was pending delivery.

- b) Some collateral was associated with repos in the GCF program. Accordingly, Lehman did not have \$8B worth of securities available for the Fed program, so they had to pull from other sources. Ultimately the FED delivery was made whole, but there were temporary shortfalls on the DTC portion.
61. There is no documentation of this. Lehman sees the Barclays funds coming in because they are sent to JPM. Lehman knew it was being funded because they had continuous communication throughout the day on an open trading line.
62. On the night of Thursday, September 18<sup>th</sup>, the \$43B of collateral was worth approximately \$41B. The classification of Lehman's pledged collateral of \$43B is:
63. This information is not in a system because it is not a standard tri-party repo. At one point it was supposed to be moved in \$5B increments, but since that did not work, \$40B was released at once.
64. You can see the FED eligible securities in MTS, but there is nothing in the Lehman systems for the DTC collateral. There was no tracking of the DTC assets.
65. The tri-party pledging with BoNY was manual. Lehman relied on BoNY to tell them what they received.
66. The FED deliverable securities are sitting in the system and as soon as JPM receives cash it moves it into a unencumbered status, and the securities get moved to BoNY.
67. Ultimately, a Fed eligible security trade can either be successful or fail, but it is our understanding, per *Mr. Hraska*, that none failed in this case.
68. *Al Lakhani* questions if we can view what intraday trading activity is done at the end of the day. *Nancy Denig* replies that it is possible to retrieve the activity from Lehman's Infopak system Cusip by Cusip, a time stamped, history for each piece of collateral that went from JMP to BoNY. The file is sent from JPM, it is not downloaded in Excel, unless JPM gives it to us in that form.
69. Relating to the box loan of \$23B on Thursday 9/18/08 - Any piece of collateral Lehman had left to make up \$23B, was pledged at flat haircuts. Lehman was given money, essentially a plug, for the value of what was left in the box unencumbered.

#### Friday, September 19<sup>th</sup>

70. The next day was a moving target; there are transaction journals that show what was deliverable streetside.
71. \$8B was cancelled, so there were no streetside trades.
72. If JPM did not deliver to BoNY, the trade would result in a fail. There were no fails on the FED deliverables, and it is irrelevant if the DTC collaterals failed. You could look at the DTC activity for the day by CUSIP number.
73. If Lehman had made DTC deliveries, then they would have received cash for that. Cash was being used to pay down the obligations of DTC.
74. The Fed eligible collateral was valued equally and the DTC collateral was out of the box.
75. At one point JPM bumped into NFE (Net Free Equity). Lehman could not get any more collateral out of the box because JPM already released \$45B, even though DTC was open. At this point, JPM was not offering Lehman a box loan. JPM felt Lehman released enough collateral and unless they were given more cash, they weren't going to release anymore.

Preliminary Document Request to Jim Hraska

1. Evidence, if any, in support of conference calls held during the period of 9/15/08 – 9/19/08. Specifically taped recordings of trader lines concerning the Barclays repo (non tri-party). (The open-ended conference call on the 9/18/08 between Lehman and JPM, referred to during our meeting on 10/8/08. Alternatively, where could we find tapes?)
2. Nancy Denig sent A&M a document titled Fed Programs-9.15-9.17.xls, detailing the tri-party repo for the dates 9/15/08 through 9/17/08. Can we get this detail for Thursday 9/18/08? Also, can we go back as early as Monday, 9/8/08?
3. Files for the period 9/08/08 through 9/18/08 in support of cash received including the following sources:
  - a. Tri-party repo transactions (including but not limited to Barclays)
  - b. Repo transactions settled through either the Fed transfer system and/or the DTC.
4. Files for the period 9/08/08 through 9/18/08 in support of tri-party repo confirmations.
5. Files for the period 9/08/08 through 9/18/08 in support of tri-party repo agreements.
6. Files for the period 9/08/08 through 9/18/08 in support of cash received from “box loans”.
7. Files for the period 9/08/08 through 9/18/08 in support of collateral pledged relating to “box loans”.
8. *Larry Servidio* mentioned that you could assist us in obtaining actual trade tickets which would indicate the collateral type and MTS#. Could we obtain these for the week of 9/15/08?
9. When Lehman prices are missing in the spreadsheet Fed Programs-9.15-9.17.xls, where can we get a JPM price? Which system are these prices coming from?

Persons to follow up on:

1. *John Feraca* – schedule to meet on Thursday 10/09/08 at 10:30 am.
2. *Larry Servidio* – schedule to meet on Thursday 10/09/08 at 7:30 am.
3. *Dan Fleming* – Mr. Fleming is part of the Lehman Treasury.
4. *Ricky Policke* - handles MTS from the technical side, uploads pricing files to MTS and performs a daily reconciliation.
5. *John Palchynsky* – Manages Tri-Party Operations.