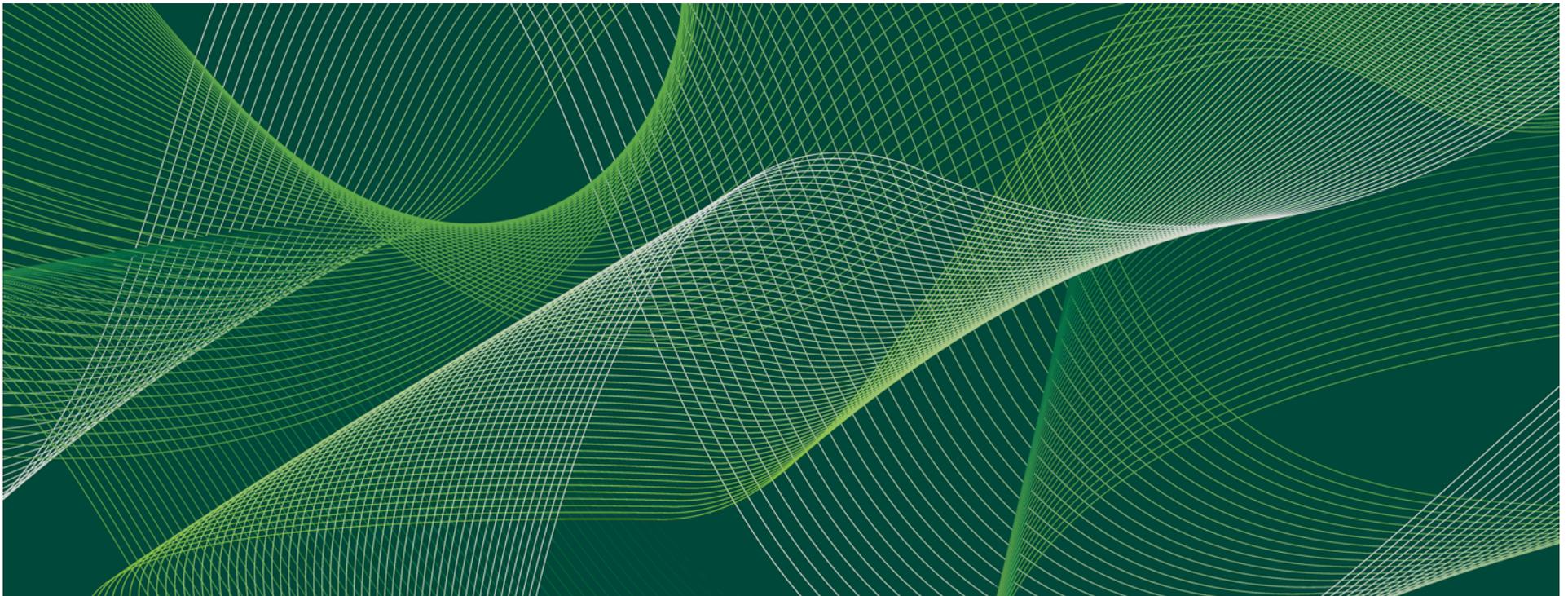


LEHMAN BROTHERS

September 11, 2008

# Capital Adequacy Review



Confidential Presentation

FOIA CONFIDENTIAL TREATMENT REQUESTED  
BY LEHMAN BROTHERS HOLDINGS, INC.

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# Overview

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**Despite Lehman's Q3 '08 performance, the Firm maintains a very strong capital profile as of the end of Q3 '08 and will be able to maintain an adequate profile subsequent to the spin-off of REI and the sale of 55% of a portion of IMD's assets**

- ◆ Pro-active issuance of \$11.9 billion of equity capital in 2008 have more than offset Lehman's losses in Q2 '08 and Q3 '08
  - Q3 '08 Tier 1 capital ratio of 11.2% higher than Q2 '08's level of 10.7%
  - Equity Surplus from Lehman's Equity Adequacy Framework (EAF) Model rose 28% from \$4.8 billion to \$6.1 billion
  - Net Leverage decreased from 12.1x to 10.1x
  
- ◆ Lehman's capital ratios will also be adequate subsequent to the REI spin-off and the sale of 55% of a portion of IMD's assets
  - Pro-forma Tier 1 ratio of 10.1% assuming \$6.0 billion of equity capital allocated to REI
  - \$2.0 billion of additional equity capital raises Lehman's Tier 1 ratio to our 11.0% target
  - Lehman maintains a \$1.7 billion surplus based on the EAF model
  - Net Leverage increases from 10.1x to 11.6x
  
- ◆ Reduction of common dividend to \$0.05/year from the current level of \$0.68/year will further support the Firm's prospective capital ratios and position
  - Will save approximately \$450 million of capital on an annual basis

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## Lehman Proactive in Raising Capital

# \$11.9 Billion of Capital Raised in 2008

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## \$1.9 B Preferred Stock

- ◆ Issued in February 2008
- ◆ Non-Cumulative Dividends at 7.95%, Perpetual
- ◆ Deeply Subordinated and senior only to Common Equity
- ◆ Included as CSE Equivalent Tier 1 Capital

## \$4.0 B Convertible Preferred Stock

- ◆ Issued in April 2008
- ◆ Non-Cumulative Dividends at 7.25%, Perpetual  
Initial Conversion Rate 20.0509 per share, equivalent to \$49.87 strike per share
- ◆ Deeply Subordinated and senior only to Common Equity
- ◆ Included as CSE Equivalent Tier 1 Capital
- ◆ More than three times over subscribed

## \$4.0 B Common Equity

- ◆ Issued in June 2008
- ◆ 143 million shares of common stock
- ◆ Public Offering price \$28 per share
- ◆ Included as CSE Equivalent Tier 1 Capital

## \$2.0 B Convertible Preferred Stock

- ◆ Issued in June 2008
- ◆ Non-Cumulative Mandatory Convertible Dividends at 8.75%
- ◆ Initial Conversion Rate between 30.2663 and 35.7142 per share at \$33.04 - \$28.00
- ◆ Deeply Subordinated and senior only to Common Equity
- ◆ Included as CSE Equivalent Tier 1 Capital

# Lehman's Hybrids Are A Low Cost of Permanent Funding

Lehman's hybrids receive very favorable equity treatment from the Rating Agencies and are a low cost form of funding

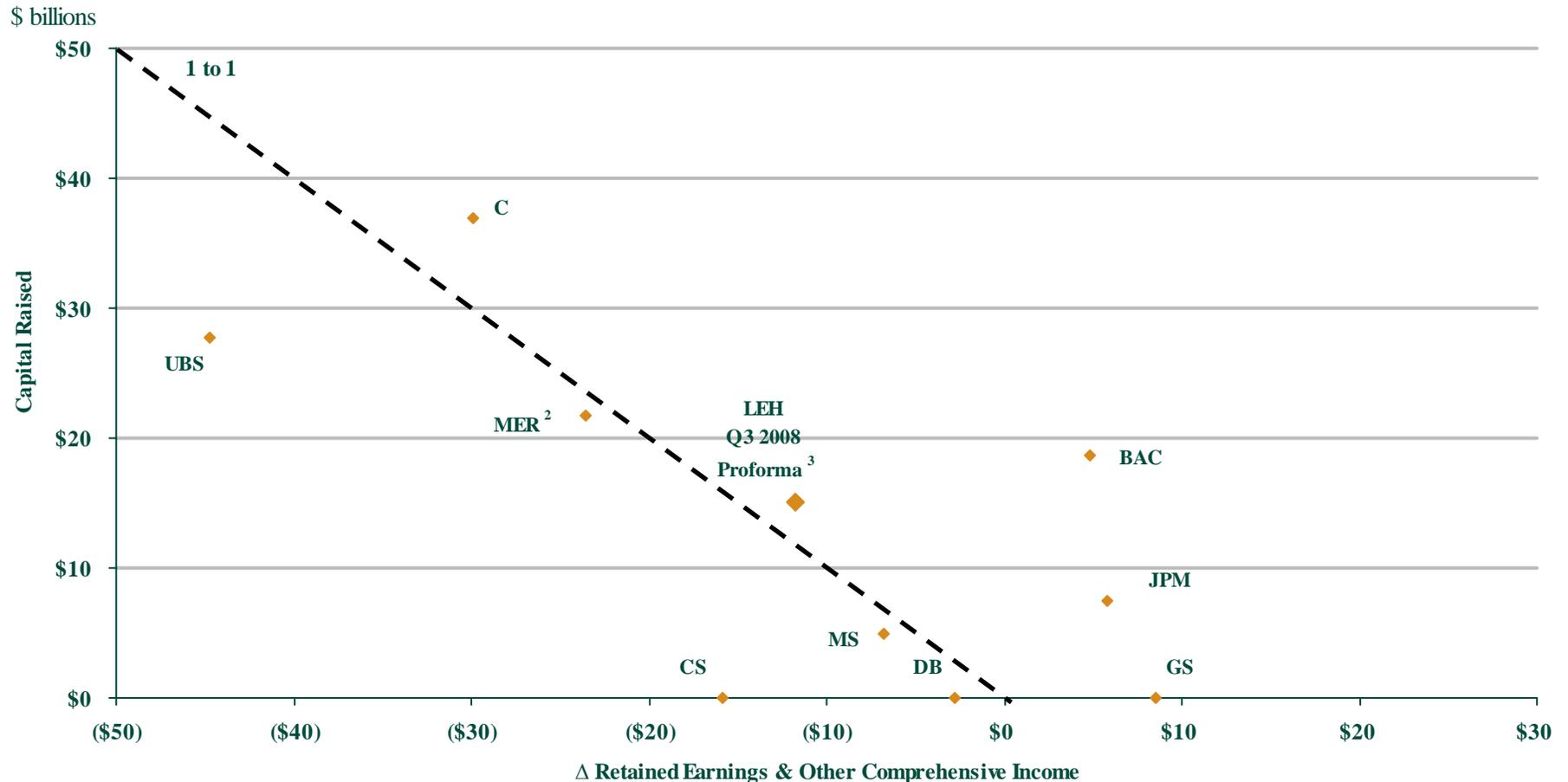
	\$ Value	Coupon	Hybrid Treatment			
			S&P	Moody's	Fitch	CSE
<b>Traditional Perpetual Preferred</b>						
Series C - Cumulative	250	5.94%	Intermediate - Strong - 33% of ACE	Bucket B - 25% Equity Credit	Bucket E - 100% Equity Credit	Restricted - 15%
Series D - Cumulative	200	5.67%	Intermediate - Strong - 33% of ACE	Bucket B - 25% Equity Credit	Bucket E - 100% Equity Credit	Restricted - 15%
Series F - Cumulative	345	6.50%	Intermediate - Strong - 33% of ACE	Bucket B - 25% Equity Credit	Bucket E - 100% Equity Credit	Restricted - 15%
Series G - Cumulative	300	5.40%	Intermediate - Strong - 33% of ACE	Bucket B - 25% Equity Credit	Bucket E - 100% Equity Credit	Restricted - 15%
Series J - Non-cumulative	1,898	7.95%	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted
Series P - Non-cumulative converts	4,000	7.25%	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted
Series Q - Mandatory Non-cumulative converts	2,000	8.75%	High - 50% of ACE	Bucket E - 100% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted
<b>Traditional Preferred Stock</b>	<b>8,993</b>					
<b>Traditional Trust Preferred</b>						
Capital Trust III	300	6.38%	Intermediate - Adequate - 12% of ACE	Bucket B - 25% Equity Credit	Bucket D - 75% Equity Credit	Restricted - 15%
Capital Trust IV	300	6.38%	Intermediate - Adequate - 12% of ACE	Bucket B - 25% Equity Credit	Bucket D - 75% Equity Credit	Restricted - 15%
Capital Trust V	400	6.00%	Intermediate - Adequate - 12% of ACE	Bucket B - 25% Equity Credit	Bucket D - 75% Equity Credit	Restricted - 15%
Capital Trust VI	225	6.24%	Intermediate - Adequate - 12% of ACE	Bucket B - 25% Equity Credit	Bucket D - 75% Equity Credit	Restricted - 15%
<b>Traditional Trust Preferred</b>	<b>1,225</b>					
<b>US ECAPS</b>						
	<b>251</b>	Y1-5:3ML+78bps Y6+:3ML+178bps	Intermediate - Adequate - 18% of ACE	Bucket D - 75% Equity Credit	Bucket D - 75% Equity Credit	Restricted - 15%
<b>Euro ECAPS/Perpetual Securities</b>						
		Y1&2: 6.625% Y3+:CMS + 10bps	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted <sup>1</sup>
UK Capital Funding I	256		Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted <sup>1</sup>
UK Capital Funding II	368	5.13%				
		Y1-Y5: 3.875% Y6+:3MEURIBOR+1.6%	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted <sup>1</sup>
UK Capital Funding III	550		Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted <sup>1</sup>
UK Capital Funding IV	294	5.75%	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted <sup>1</sup>
UK Capital Funding V	500	6.90%	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket E - 100% Equity Credit	Unrestricted <sup>1</sup>
<b>Euro ECAPS</b>	<b>1,969</b>					
<b>MCAP</b>						
	1,000	First 5 yrs: 5.857% 5yrs+ Preferred @ / 4% floor	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket D - 75% Equity Credit	Restricted - 25%
	475	First 5 yrs: 3ML+83bp 5yrs+ Preferred @ / 4% floor	Intermediate - Strong - 33% of ACE	Bucket D - 75% Equity Credit	Bucket D - 75% Equity Credit	Restricted - 25%
	<b>1,475</b>					

1. Euro ECAPS/Perpetual Shares are treated as 'Unrestricted', as Lehman received special approval from the SEC. If Fed Rules were strictly followed, these securities would be restricted to 15% of Tier 1

# Lehman Proactive in Replenishing Capital

Lehman has proactively raised capital when markets were opportune and has been able to cover depressed earnings during the current downturn

**Capital Raised versus Retained Earnings and Other Comprehensive Income Q3 '07 to Q2 '08<sup>1</sup>**

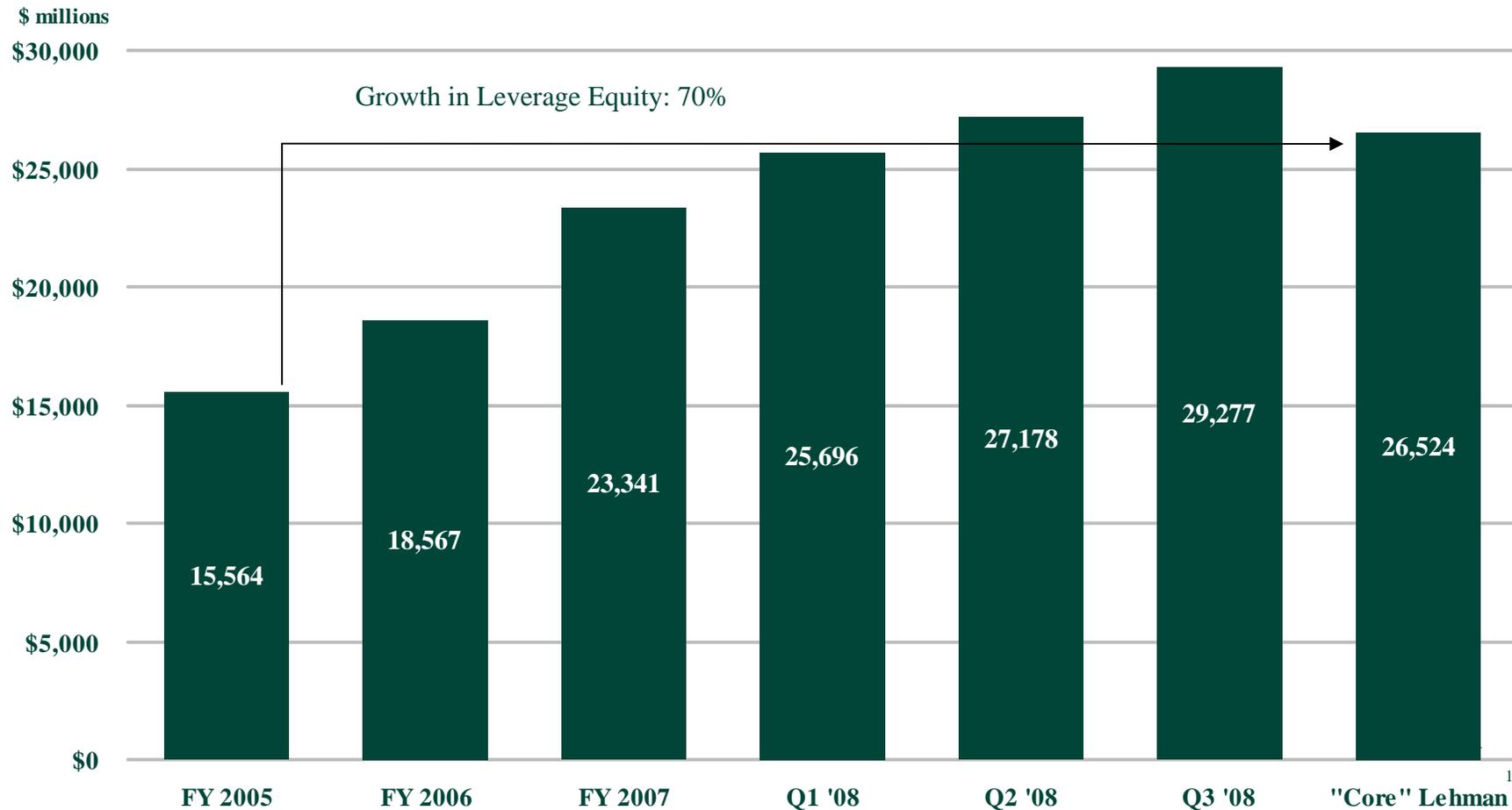


1. All peers as of Q2 '08 and includes equity capital raised through 8/15/08  
 2. MER capital raised as of Q2 '08 + After tax gain on sale of Bloomberg \$2.8B and FDS \$2.3B + Common Stock offering of \$8.5B. Decrease in Retained Earnings includes After-tax Writedowns of ABS CDOs / Monolines of \$3.7B - \$1.6B After-tax payment to Temasek as reset provision - \$2.4B of additional dividends for exchange of existing mandatory convertible preferred to common stock  
 3. LEH Q3 '08 proforma for \$6.0B equity investment in SpinCo, partially offset by increase to Tier1/Tangible Equity of \$3.3B on 55% sale of IMD

# FY 2009 Post-SpinCo Equity Stronger Than Before

Despite the losses and the CRE spin-off, Lehman's capital base will be strong with capital enhancements

## Total Leverage Equity



Shareholders' Equity includes Common + Preferred Equity + Junior Subdebt - Goodwill  
 1. LEH shareholders' equity in "Core" Lehman reflects impacts of SpinCo and 55% IMD sale

# Capital Adequacy

Lehman's capital position subsequent to "SpinCo" and other de-risking initiatives will be adequate

## Capital Adequacy "Core" Lehman

<i>\$ millions</i>	Q2 2008	Q3 2008	SpinCo	Q3 2008 Proforma "Core" Lehman	IMD 55% Sale	Q3 2008 Proforma "Core" Lehman
+ Total Common	19,284	19,450	(6,000) <sup>1</sup>	13,450	22 <sup>2</sup>	13,472
+ Total Preferred	6,993	8,993		8,993		8,993
+ Hybrids (excl. Preferreds)	5,004	4,919		4,919		4,919
= <b>Permanent Capital</b>	<b>31,280</b>	<b>33,362</b>		<b>27,362</b>		<b>27,384</b>
- Goodwill	4,101	4,085		4,085	(3,225) <sup>3</sup>	860
= <b>Leverage Equity</b>	<b>27,179</b>	<b>29,277</b>		<b>23,277</b>		<b>26,524</b>
Deferred Tax Assets, net of realizable within 1 year	(2,209)	(4,509)		(4,509)	(143) <sup>4</sup>	(4,652)
Capital requirements for insurance entities	(138)	(138)		(138)		(138)
Cumulative fair value gains on debt, net of taxes	(1,511)	(2,437)		(2,437)		(2,437)
- Total Capital Deductions	(3,858)	(7,084)		(7,084)		(7,227)
= <b>Tier 1 Capital</b>	<b>23,262</b>	<b>22,193</b>		<b>16,193</b>		<b>19,297</b>
= <b>Total Capital</b>	<b>34,892</b>	<b>33,289</b>		<b>24,289</b>		<b>28,945</b>
Risk Weighted Assets	216,575	199,000	(12,500) <sup>5</sup>	186,500	5,625 <sup>6</sup>	192,125
Tier 1 Ratio	10.7%	11.2%		8.7%		10.0%
Total Capital Ratio	16.1%	16.7%		13.0%		15.1%
Net Assets	327,774	310,915	(6,000) <sup>7</sup>	304,915	1,965 <sup>8</sup>	306,880
Net Leverage	12.1x	10.6x		13.1x		11.6x
Gross Assets	639,432	600,000	(6,000)	594,000	(1,260) <sup>9</sup>	592,740
Net Leverage	24.3x	21.1x		26.5x		26.4x

1. 20% Equity investment in SpinCo with \$30B Commercial Real Estate portfolio

2. Gain on 55% of \$3.549 Cash Proceeds over \$3.510B Book Value

3. Decrease of Neuberger goodwill removed from LEH balance Sheet

4. Adjustment to Q3 '08 DTA due to IMD valuation assumptions

5. Net reduction from removing \$30 CRE assets and adding \$24B of Seller Financing 75% risk weighting

6. Remaining 45% Minority stake of \$5B IMD value with 250% risk weighting

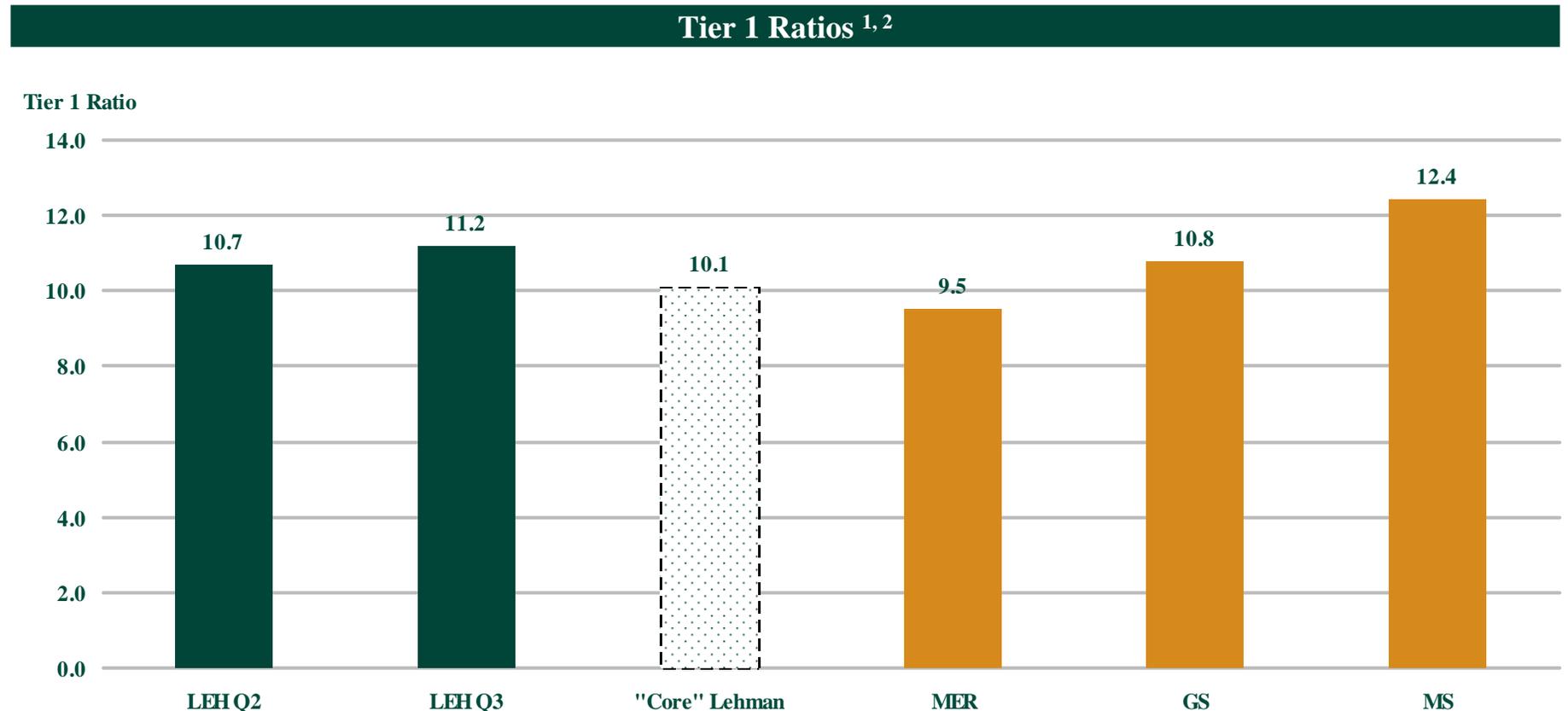
7. Net of removing \$30B CRE Assets and adding \$24B of Seller Financing

8. Add 45% Minority stake of \$5B IMD value minus book value above Goodwill of \$3.2B

9. Add 45% Minority stake of \$5B IMD value minus \$3.5B Book Value of IMD assets

# CSE Tier 1 Ratios LEH vs. Peers

The Firm has maintained a strong Tier 1 ratio under the CSE guidelines and its estimated to remain within its peers range even after the announced strategic initiatives



1. "Core" Lehman accounts for impact to Tier 1 due to REI Spin and 55% IMD Sale

2. Peers are as of Q2 08

# CSE Capital Components

Lehman's CSE capital ratios subsequent to capital restructuring will be adequate

## CSE Capital Components of "Core" Lehman

<i>\$ millions</i>	Q2 2008	Q3 2008	SpinCo	Q3 2008 Proforma "Core" Lehman	IMD 55% Sale	Q3 2008 Proforma "Core" Lehman
Core Elements						
Unrestricted Core Capital Elements	27,171	29,312	(6,000) <sup>1</sup>	23,312	22 <sup>2</sup>	23,334
Restricted Core Capital Elements	4,050	4,050		4,050		4,050
<b>Total Core Capital Elements</b>	<b>31,221</b>	<b>33,362</b>		<b>27,362</b>		<b>27,384</b>
Deductions						
Goodwill & Intangibles	(4,101)	(4,085)		(4,085)	3,225 <sup>3</sup>	(860)
Deferred Tax Assets, net of realizable within 1 year	(2,209)	(4,509)		(4,509)	(143) <sup>4</sup>	(4,652)
Capital requirements for insurance entities	(138)	(138)		(138)		(138)
Cumulative fair value gains on debt, net of taxes	(1,511)	(2,437)		(2,437)		(2,437)
<b>- Total Capital Deductions</b>	<b>(7,959)</b>	<b>(11,169)</b>		<b>(11,169)</b>		<b>(8,087)</b>
<b>= Tier 1 Capital</b>	<b>23,262</b>	<b>22,193</b>		<b>16,193</b>		<b>19,297</b>
<b>= Total Capital</b>	<b>34,892</b>	<b>33,289</b>		<b>24,289</b>		<b>28,945</b>
Risk Weighted Assets	216,575	198,000	(12,500) <sup>5</sup>	185,500	5,625 <sup>6</sup>	191,125
Tier 1 Ratio	10.7%	11.2%		8.7%		10.1%
Total Capital Ratio	16.1%	16.8%		13.1%		15.1%

1. 20% Equity investment in SpinCo with \$30B Commercial Real Estate portfolio

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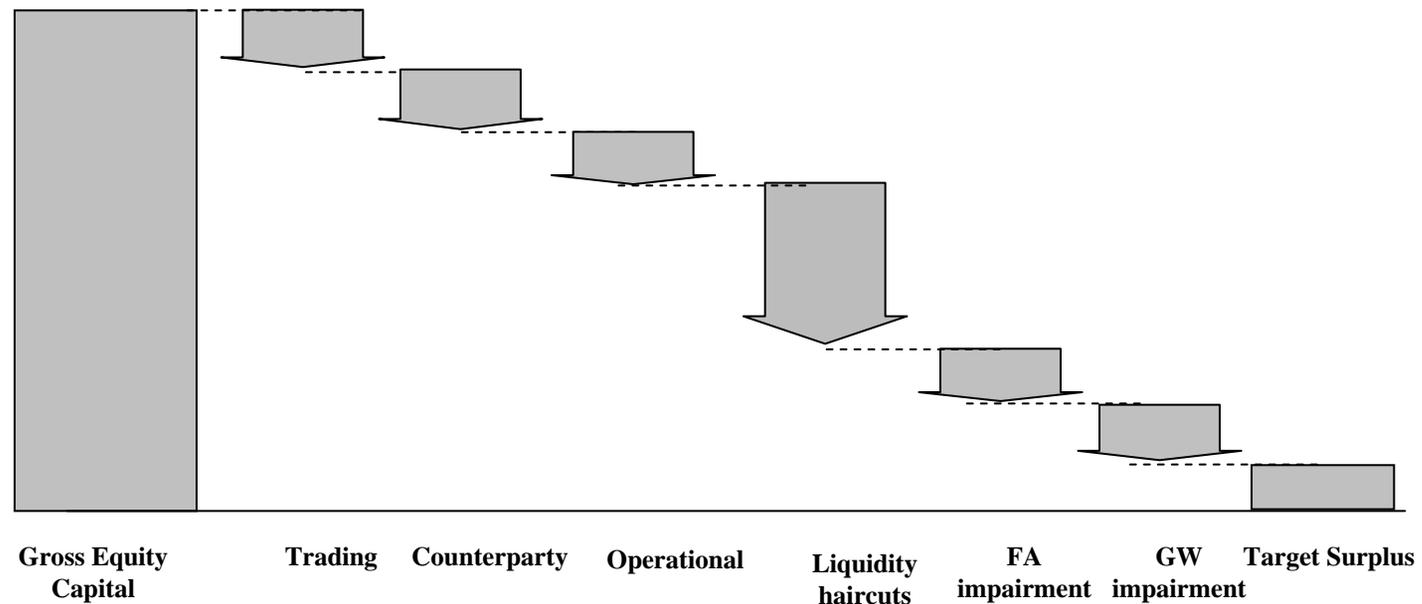
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## Equity Adequacy

# Equity Adequacy Framework (EAF)

The equity allocation framework (EAF) calculates the equity required to enable restructuring in crisis outside of bankruptcy without access to unsecured debt. The model incorporates both risk and liquidity considerations and can be applied at different levels of granularity: the Firm, the Divisions, BPMs, and even trades

## Equity Compression in Crisis



$$\underbrace{\left\{ \begin{array}{l} \text{Common} \\ \text{Equity} \end{array} \right\} + \left\{ \begin{array}{l} \text{Hybrid} \\ \text{Equity} \end{array} \right\}}_{\text{Available Equity}} - \underbrace{\left\{ \text{Trading} + \text{Counterparty} + \text{Operational} + \text{Less-Liquid} + \text{Impairment} + \text{Target Surplus} \right\}}_{\text{Required Equity}} \geq 0$$

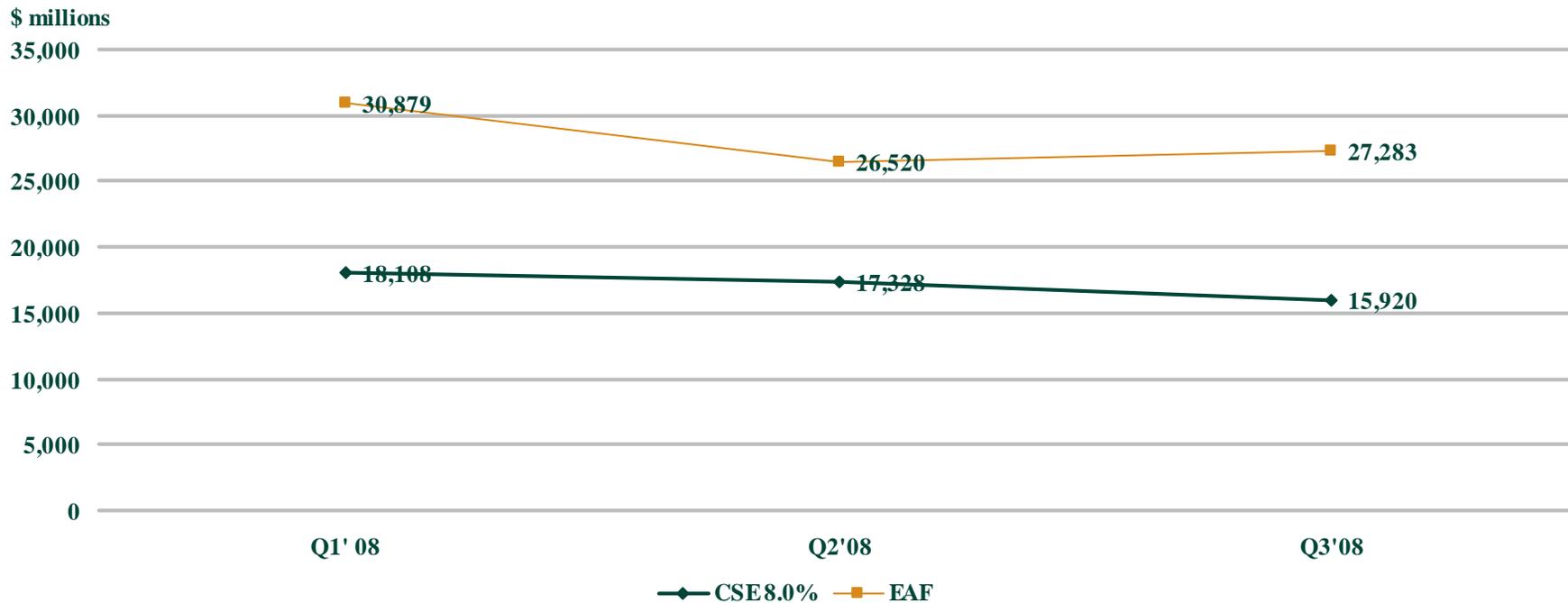
# Parameters of Model

Component	Includes	Approach
<b>Trading Loss</b>	<ul style="list-style-type: none"> <li>• Market Risk</li> <li>• Credit Risk</li> </ul>	<ul style="list-style-type: none"> <li>• VaR-driven</li> <li>• Reflects maximum loss over 1 year holding period with 99.97% confidence level</li> </ul>
<b>Counterparty Loss</b>	<ul style="list-style-type: none"> <li>• Financing and derivative exposure</li> </ul>	<ul style="list-style-type: none"> <li>• MPE (Probability of default and expected recovery in default)</li> </ul>
<b>Liquidation Loss</b>	<ul style="list-style-type: none"> <li>• Liquidity Haircuts on LLA's</li> <li>• Devaluation of Fixed assets</li> <li>• Devaluation or loss of intangible assets</li> </ul>	<p>Triangulated based on</p> <ul style="list-style-type: none"> <li>• Estimated discount in fire sale</li> <li>• Haircut for non-recourse financing</li> <li>• Equity requirement in CDO structure</li> </ul> <p>Estimated by marking to market, then taking same haircuts as on illiquid assets</p> <p>Estimated by marking "Separable" assets to market, then taking same haircuts as on Corporate Investments</p>
<b>Operational Loss</b>	<ul style="list-style-type: none"> <li>• Operational loss</li> <li>• Litigation loss</li> </ul>	<ul style="list-style-type: none"> <li>• Percent of revenues</li> </ul>
<b>Target Surplus</b>	<ul style="list-style-type: none"> <li>• Protection against unexpected</li> <li>• Reserve for tactical opportunities</li> </ul>	<ul style="list-style-type: none"> <li>• \$1.5 B</li> </ul>

# Comparing the Models: Equity Requirements

Comparison of Equity Adequacy Framework (EAF) and CSE Models indicates close alignment. The difference between absolute requirements of the two models is driven by the fact that Tier 1 equity is, by definition, lower than Gross Equity.

Absolute Equity Requirements by Model



# Equity Adequacy Framework

## The Firm maintains its surplus even after the REI spin-off and 55% IMD Sale

### Equity Adequacy Framework

<i>In \$ millions</i>	<u>Q2 '08</u>	<u>Q3 '08 E</u>	<u>SpinCo Transaction<sup>1</sup></u>		<u>55% IMD Sale</u>	<u>Q3 '08 'Core' LEH</u>
			CRE + Other Assets -off	Seller Fin - on		
<b><u>Equity Required</u></b>						
Trading	3,469	3,646	-298	211		3,349
Counterparty	940	1,156				1,156
Less Liquid Funding Haircuts <sup>4</sup>						
{ <i>Less Liquid assets</i>	<i>14,641</i>	<i>13,492</i>	<i>-3,851</i>	<i>2,730</i>		<i>12,371</i>
{ <i>Fixed assets</i>	<i>3,551</i>	<i>3,551</i>	<i>-76</i>		<i>-291</i>	<i>3,475</i>
{ <i>Goodwill</i>	<i>876</i>	<i>876</i>				<i>876</i>
{ <i>DTA</i>	<i>2,080</i>	<i>3,600</i>	<i>-49</i>		<i>-231</i>	<i>3,551</i>
Total	21,147	21,519	-3,976	2,730	-522	20,272
Operational	963	963	-65		-80	898
<b>Total Gross Equity Required Before Target Surplus</b>	<b>26,520</b>	<b>27,283</b>	<b>-4,339</b>	<b>2,941</b>	<b>-602</b>	<b>25,675</b>
<b><u>Gross Equity Available</u></b>						
Common Equity	19,283	19,450	-6,000		22	13,472
Hybrids/Preferred	11,997	13,912				13,912
<b>Total Gross Equity</b>	<b>31,280</b>	<b>33,362</b>	<b>-6,000</b>			<b>27,384</b>
<b>Surplus/(Deficit)</b>	<b>4,760</b>	<b>6,079</b>				<b>1,709</b>

Notes:

<sup>1</sup> \$30CRE Assets with \$6.0B in equity spin-off and \$24B in Seller financing in Q4 '08