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**Sent:** Monday, June 9, 2008 11:21 AM (GMT)  
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**Subject:** FW: (BMP) Moody's changes Lehman's rating outlook to negative

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-----Original Message-----

From: STEPHEN B LAX, LEHMAN BROTHERS, INC [<mailto:slax@bloomberg.net>]

Sent: Monday, June 09, 2008 7:21 AM

To: Lax, Stephen

Subject: (BMP) Moody's changes Lehman's rating outlook to negative

Moody's changes Lehman's rating outlook to negative  
2008-06-09 07:20 (New York)

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Moody's changes Lehman's rating outlook to negative

New York, June 09, 2008 -- Moody's Investors Service lowered the rating outlook on Lehman Brothers Holdings Inc. ("LBHI", senior at A1) to negative from stable and affirmed the rating on the senior long-term debt of the company and its principal rated operating and guaranteed subsidiaries (all referred to collectively as "Lehman"). Today's rating action follows Lehman's reporting of a \$2.8 billion net loss in Q2-08 that resulted from a combination of asset valuation marks and a sharp decline in hedge effectiveness, which had previously buffered Lehman's bottom line from material losses. Moody's notes, however, that the firm would have been just above breakeven in the first quarter of the year if gains on its structured notes were excluded from income.

Concurrent with its earnings announcement, Lehman will seek to offset the negative capital impact of the loss by issuing \$4 billion of new common shares and \$2 billion of 3-year mandatory convertible preferred stock.

Moody's views the capital raise, in conjunction with balance sheet de-leveraging/de-risking, as a positive step in bolstering both the balance sheet and investor confidence.

The rating action also reflects Moody's concerns over risk management decisions that resulted in elevated real estate exposures and the

subsequent ineffectiveness of hedges to mitigate these exposures in the recent quarter. However, the significant (albeit declining) residential and commercial real estate concentrations remain a risk management challenge and continue to pose down-side risk to the firm. Any additional net valuation marks that result in firm-wide losses in coming quarters would raise serious concerns about the effectiveness of Lehman's risk management and may create additional market unease about the firm, potentially weakening its franchise. As such, additional firm-wide losses would likely result in a downward rating action. Stabilization of the rating outlook would require a return to consistent profitability and continued reduction in Lehman's currently outsized commercial and residential mortgage exposures.

Lehman's rating also reflects the firm's product and geographic earnings diversification, which has improved materially over the past five years on steady growth in primary equities, global advisory, and investment banking. The firm has built strong franchises in investment banking and equity capital markets, including increasing its penetration in prime brokerage and secondary cash equities and derivatives, in both the U.S. and abroad. The rating agency said that despite tough market conditions, Lehman's core customer-flow franchises continue to produce solid revenues, with profits generated from outside of fixed income helping to counter current weakness in residential and commercial real estate and leveraged lending. Lehman's investment management business has also become an important earnings contributor to the firm.

Moody's noted that Lehman's liquidity management and stand-alone liquidity position remain robust and are underpinned by a funding framework that is scaled to the firm's expectations for reliable secured funding, which is vetted by counterparty and asset type. The contingency funding plan also assumes stress-level valuation haircuts, and anticipates a substantial reduction in the availability of secured funding in a stress scenario. The use of prime brokerage free credit balances to fund customer assets is minimal, with Lehman assuming 100% flight of free credits in a stress scenario. Lehman ended Q2-08 with a record \$45 billion of liquidity available to the holding company, and an additional \$150 billion of unencumbered assets, with substantial loan value.

The rating agency noted that the recent collapse of Bear Stearns highlights the vulnerability of the secured funding model of broker-dealers on overall market liquidity. When market liquidity dries up, collateral becomes harder to value, margin disputes arise and liquidity pressure increases on broker-dealers. The supportive actions of the Federal Reserve, including the temporary introduction of the Primary Dealer Credit Facility ("PDCF") and the Term Securities Lending Facility ("TSLF"), have played a critical role in helping to stabilize funding markets in the wake of the Bear Stearns collapse. These actions have provided at least an interim solution to industry-wide structural liquidity challenges. However, neither facility is permanent in nature. The negative outlook also reflects the risk that a more permanent solution to the inherent confidence sensitivity of the securities industry funding model may not be forthcoming. In the absence of a more permanent solution, Moody's believes the newly revealed vulnerability of the secured funding model may warrant negative rating action on Lehman and on other independent investment banks.

Moody's last rating action on Lehman was on March 17, 2008 when the ratings were affirmed and the outlook was revised to stable from positive.

Lehman Brothers Holdings Inc. is an international investment bank and financial services firm headquartered in New York, NY with total stockholders equity of approximately \$31.3 billion and \$160 billion of long-term capital at May 31, 2008.

The rating outlooks on the following Lehman Brothers entities have been changed to negative from stable:

Lehman Brothers Holdings Inc.

Lehman Brothers, Inc.

Lehman Brothers Bank, FSB

Lehman Brothers Bankhaus AG

Lehman Brothers Commercial Bank

Lehman Brothers Holdings Plc

Lehman Brothers International (Europe)

Lehman Brothers OTC Derivatives Inc.

Lehman Brothers Special Financing Inc.

Lehman Brothers Treasury Co. B.V.

Lehman Brothers Holdings Capital Trust I

Lehman Brothers Holdings Capital Trust II

Lehman Brothers Holdings Capital Trust III

Lehman Brothers Holdings Capital Trust IV

Lehman Brothers Holdings Capital Trust V

Lehman Brothers Holdings Capital Trust VI

Lehman Brothers Holdings E-Capital Trust I

Lehman Brothers UK Capital Funding LP

Lehman Brothers UK Cap.Fund. II

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