

Aggregated Risks

- Risk Appetite usage is \$4.27bn (up \$469mm on week)
 - VaR usage is \$158.5mm (up \$39.9mm on week)
 - Risk driven by \$1.19bn increase in Equity Delta accompanied by \$229mm Gamma reduction, and increase in correlation between FID and Equities as GCP increased their outright equity exposures
- Long Equity Division delta exposure of \$3.599bn; long \$2.682bn excluding event driven trades -> potential \$95mm loss if all markets down 5%
- Total HY and HG commitments: \$39.9bn (\$8.9bn funded)
 - HY Commitments: \$29.6bn (\$7.3bn funded)
 - HG Commitments: \$10.3bn (\$1.6 funded)
- Long credit spread exposure ->\$430mm potential loss for a 10% relative, to current respective levels, widening of spreads (up \$18mm on week)

Ellington Management Group

- Ellington (AUM \$5.5bn) suspended redemptions in 2 of their funds due to their inability to obtain clear prices on certain late '04 and early '05 vintage residuals that are scheduled to receive overcollateralization cash if the deals met credit performance triggers on 10/25.
 - Ellington Credit Fund (Aug -5.5%; Aug YTD -9.7%; NAV \$1.3bn)
 - Ellington Mortgage Partners (Aug -4.3%; Aug YTD -5.4%; NAV \$486mm)
- Ellington is hoping to release suspensions once the residuals receive the cash. If the bonds do not, then Ellington will have to take further write-downs, which may lead additional redemptions.
- Ellington emphasized that its decision is related to ensuring fairness between redeeming investors and those remaining, and not related to any liquidity problems. Thus far, the funds are not facing significant redemptions, meeting all margin calls and appear to have sufficient cash.
- Lehman exposure:
 - ECF and EMP (the two affected funds): we have \$143mm loan amount of repo vs. \$207mm of bonds; \$92mm notional sold protection on ABS CDS vs. \$18m notional bought protection on ABS CDS; \$247mm notional IRS
 - We are active with 7 other funds in repo, rates and CDS and have combined MPE across all Ellington funds of \$20mm.

Kazakh Bank Exposure

- EMG desk is exposed to Kazakh banks that are experiencing liquidity problems stemming from the global credit crisis and the country faces a possible ratings downgrade (currently rated Baa)
- Exposure is through an outright loan, CDS and cash positions. Potential loss in default scenario would be approximately \$50mm (20% recovery assumed):
 - \$45mm loan to JSC Astana Finance, a project finance/leasing company owned by the capital city of Astana, rated Ba1 with \$684mm in assets and \$62mm in equity. Loan is termed out to November 2011, marked at 550 bps (98 price). In a default scenario we could lose approximately \$36mm (20% recovery)
 - \$10mm sold CDS on Halyk Savings Bank Kazakhstan, a quasi-sovereign commercial bank owned by the son-in-law and heir apparent of the president of Kazakhstan, rated Ba1 with \$7.5bn in assets and \$905mm in equity. In a default scenario, we could lose \$8mm (20% recovery)
 - Spread trade between Kazkommertsbank ("KKB", short \$44k/bp PV01) and Bank TuranAlem ("BTA", long \$21k/bp PV01). If current spreads (427 bps for KKB, 525 bps for BTA) widened 250 bps we would lose \$5mm. KKB, rated Baa2, is the largest commercial bank in Kazakhstan with \$25bn in assets and \$2bn in equity. BTA, rated Baa3, is the second largest commercial bank in Kazakhstan with \$16bn in assets and \$1.3bn in equity.
- Lehman Research believes the likelihood of imminent default of any of these banks to be low but could rise significantly over the next six months should liquidity problems persist.

AHMSA Restructuring Loan

- Lehman has been asked by Altos Hornos de Mexico, S.A. de C.V. (AHMSA) to provide committed debt financing in support of AHMSA's exit from bankruptcy. AHMSA is the largest fully integrated steel producer in Mexico. The company declared bankruptcy in May 1999.
- D.E. Shaw, Black River and Ashmore are existing creditors who will convert \$500mm of their debt holdings into 22.75% of the reorganized company's equity. The exit date is expected to be in April 2008.
- In order to exit bankruptcy, AHMSA needs to have committed financing in place. As such, Lehman is being asked to provide a commitment within the next month. Lehman is competing against CS on the financing, although we are working to provide a joint commitment. Lehman commitment to include Business and Market MACs as well as other funding conditions.
- Financing package is a \$1.0bn bridge loan, to be taken out by \$1.0bn senior notes. We will attempt to reduce our exposure by syndicating the bridge commitment and also pre-selling the

European Residential Mortgage Update

- \$9bn total exposure, consisting of whole loans (71%), secondary RMBS bonds including retained securitizations (26%) and residual positions (3%).
- UK non-conforming mortgages represents 69% of exposure, Dutch non-conforming 9%, Italian prime 9% and other 13%. Unsold inventory from recent securitizations totals \$1.4bn and is principally UK nonconforming (78%) and AAA (60%).
- The secondary market reopened in September and has stabilized with modest trading levels. AAA UK nonconforming spreads widened as far as 80-100bps, up from 50bps in August and 20bps in June; BBB spreads widened to 500bps from 425bps in August and 145bps June. UK prime RMBS AAA levels have firmed at 35bps from being as wide as 45bps in August, compared to 10bps in June.
- The new issue market reopened in early October with small amounts of CDO, Australian RMBS and Dutch RMBS (government collateral) pricing. RMBS issuers in the Netherlands, Spain and other jurisdictions are closing deals, with the market expectation that collateral is being used for repos.
- In the past few weeks LB has sold \$500mm of retained UK and Dutch nonconforming bonds and received an order for \$420mm of UK Alt A collateral.
- Our view is that liquidity is the main market issue as investors see European fundamentals as generally still strong; however there is still careful investor scrutiny on the UK non-conforming market for signs of a US-style subprime deterioration.
- The average deal performance of the UK non-conforming deal to date has been relatively unchanged over the past year, however in recent vintages, CDR and loss severities are increasing. 90+ delinquencies across LB securitized pools averaged 10% in Sep-07 compared to 9% in 2006.
- On 9/25 a \$37mm charge was taken on UK nonconforming positions, which is on top of \$93mm of writedowns across the entire European mortgage book taken in August. If we experience a further 50% spread widening, losses on the UK and Dutch non-conforming positions could be \$50mm. These credit exposures are relatively unhedged due to limited CDS availability and lack of UK ABS index comparable to the ABX in the US.

FNMA 30yr 6.5% Mortgage Position

- The mortgage trading desk had recently accumulated a \$35.5 bn long Oct settlement/short Nov settlement roll position. The dollar roll market is a financing trade similar to a repo where the price of the roll varies between cost of carry (normal market) to a maximum of fail cost and is driven by both prepayment view and market demand for the particular security.
- The desk chose not to roll \$29bn and instead to take actual delivery of the securities. Initially, we had \$4bn fail to deliver to us, which was reduced to \$900mm by 10/12 and we expect the remainder to be delivered this week. The benefit of fails over the last few days is approximately \$1.4mm. The desk will also try to monetize the value in specified pools that were delivered which trade better than TBAs.
- The repo/funding desk is involved in the transaction and expect the overnight funding rate for delivered mortgage pools to be in 4.8%-4.9% range. The delivered pool will continue to general carry income as long as agency mortgage funding rate does not go above 5.2% for extended period of time. The market risks of the delivered pools are largely hedged with the short positions in Nov settlement.
- The desk intends to deliver the mortgage pools received into November TBA settlement cycle to bring down balance sheet usage.

bonds by funding into escrow prior to the exit.