

## 2006 Competitor Analysis

### Summary of Key Considerations

#### Balance Sheet Disclosures:

1. Disclose real estate held separately in the Financial Instruments footnote. **YES**
2. Disclose deposit liabilities as a separate line item on the face of the balance sheet called “Deposits”. **YES**
  - LB balance of \$21.2B at 8/31/06 represents 5% of LB’s liabilities. ML and MS disclose separately, and their percentages are 10% and 3%, respectively.

#### Risk:

3. Stress testing of real estate and private equity positions. **UNDER CONSIDERATION**
4. Historical simulation VaR – create two-year table and disclose same information as done for net revenue volatility VaR (average, high and low along with “as of”). **UNDER CONSIDERATION**
5. Disclose number of days that P&L exceeded VaR. **UNDER CONSIDERATION**

#### Securitizations:

6. Secondary market purchases – determine if anybody else includes these assets in their stress tests. GS and JPM are explicit that they exclude these assets. **CURRENTLY INCLUDING, BUT BEING RESEARCHED**
7. Securitization gains – do not recommend disclosing **NOT DISCLOSING**
  - ML discloses an amount; MS states their balance is immaterial.

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8. Disclose unpaid principal balances, delinquencies and associated net credit losses of outstanding securitized portfolio for which LB holds a retained interest. See attached **Exhibit 1** from Merrill (JPM also discloses). **NOT DISCLOSING**
  - MS and BS do not disclose their credit losses, but make statement that is not material.

**Commitments, Contingencies and Guarantees:**

9. Disclose amount for commitments to purchase mortgages as done by ML. **DISCUSS WITH COMPETITORS**
  - At Q3, LB was \$15.5B, ML was \$13.7B and BS was \$4.8B.
  - If include, will either need to: (a) put in other commitments section; or (b) break out mortgage-related commitments separately. ML does (a) and BS does (b).
10. Disclose amount of margin lending transactions entered into on a committed basis as done by ML. MS and LB discuss concept, but do not quantify. **DETERMINED ALREADY ON BALANCE SHEET (ALREADY FUNDED)**
  - Discussing with Treasury, Firm Financing and Risk to determine size of exposure (relates to hedge funds within prime brokerage business) and how being risk-managed.
11. Disclose maximum potential exposure and probable exposure (would be reserved amount) related to general partner clawbacks in Private Equity as done by MS. **NOTHING MATERIAL TO DISCLOSE GIVEN RECOGNITION POLICY**
  - Began discussion with Private Equity Finance, and number of questions arose as to what would be proper disclosure (base on cash proceeds versus P&L impact to LB).

**Employee Incentive Plans:**

12. Disclose RSU's in a tabular format comparable to GS and ML by those that require future service versus those that do not. See attached **Exhibit 2** from GS Q3 10-Q. **DISCUSSING WITH COMPENSATION CONTROL**

**Merrill Lynch - Delinquencies and Credit Losses Table**

The following table summarizes principal amounts outstanding and delinquencies of securitized financial assets as of September 29, 2006 and December 30, 2005:

*(dollars in millions)*

	<b>Residential Mortgage Loans</b>	<b>Municipal Bonds</b>	<b>Other</b>
<b>September 29, 2006</b>			
Principal amount outstanding	\$ 107,276	\$ 18,942	\$ 17,475
Delinquencies	2,427	–	11
<b>December 30, 2005</b>			
Principal amount outstanding	\$ 82,468	\$ 19,745	\$ 10,416
Delinquencies	688	–	–

Net credit losses associated with securitized financial assets for the nine months ended September 29, 2006 and September 30, 2005 approximated \$79 million and \$32 million, respectively.

**Merrill Lynch – Rollforward of RSUs Based Upon Future Service Required**

SFAS No. 123R requires the immediate expensing of share-based payment awards granted or modified to retirement-eligible employees in 2006, including awards that are subject to non-compete provisions. The above activity contains awards with or without a future service requirement, as follows:

	<b>No Future Service Required</b>		<b>Future Service Required</b>	
	<b>Shares/ Units</b>	<b>Weighted Avg Grant Price</b>	<b>Shares/ Units</b>	<b>Weighted Avg Grant Price</b>
<b>Outstanding at December 30, 2005</b>	<u>38,877,644</u>	\$ 51.00	<u>12,672,978</u>	\$ 54.01
Granted — 2006	7,429,380	71.57	16,796,318	71.43
Delivered	(1,172,820)	46.12	-	-
Forfeited	(1,874,537)	57.82	(580,321)	61.04
Service criteria satisfied (1)	<u>20,214,490</u>	64.72	<u>(20,214,490)</u>	64.72
<b>Outstanding at September 29, 2006</b>	63,474,157	57.66	8,674,485	62.33

*(1) Represents those awards for which employees attained retirement-eligibility during 2006, subsequent to the grant date.*

## Securitized and Other Off-Balance Sheet Arrangements

Disclosures made by the five investment banks are as follows:

	LEH	GS	ML	MS	BS
<u>Interests in Securitized</u>	✓	✓	✓	✓	✓
Retained interests:					
• Retained interests held in QSPEs and amount of purchased interest of residential mortgage QSPEs in secondary markets		✓			
• Fair Value of retained interests based on quoted market price		✓			
• Composition of retained interests		✓			✓
• Holding period of retained interests					✓
Stress Test:					
• Total retained interests	✓		✓	✓	✓
• Hard to value retained interests		✓			
• Additional caveats on retained interests sensitivity analysis			✓	✓	✓
<u>Cash Flows on securitization transactions</u>	✓	✓	✓	✓	✓
Cash flows from retained interests	✓	✓		✓	✓
Cash flows from servicing	✓				✓
<u>MSR Rollforward and Stress Test</u>	✓				✓
MSR sensitivity analysis detail by sub prime, fixed rate prime and adj rate prime					✓
Additional caveats on MSR sensitivity analysis					✓

	LEH	GS	ML	MS	BS
<u>Securizations Volume</u>	✓	✓	✓	✓	✓
Amount of securitizations during the period	✓	✓	✓		✓
Net securitization gains			✓	✓	
Call options on securitized transactions					✓
Principal amount outstanding, delinquencies and net credit losses on securitized financial assets			✓	✓	✓
Investors non recourse to other assets of the company			✓		
 <u>VIE</u>	✓	✓	✓		✓
Composition of variable interest in VIE		✓			
VIE transaction and guarantees		✓			
VIE Asset detail with maximum exposure to loss-consolidated and unconsolidated VIE shown in tabular form		✓			

**Observation #1:**

- GS discloses the portion of retained interests held in QSPEs and quantifies the fair value of these retained interests based on quoted market prices. In addition, GS discloses the amount of interests in residential mortgage QSPEs purchased in connection with secondary market-making activities.

**Consideration:**

- LB's retained interests held in QSPEs, the amount of interests in residential mortgage QSPEs purchased in connection with secondary market-making activities and the FV of retained interests based on quoted market prices is obtainable by our mortgage group. Consider disclosure of these items if deemed beneficial.

**Observation #2:**

- GS and BS disclose that retained interests are primarily in the form of senior, subordinated securities and residual interest.

**Recommendation:**

- No change to LB's current disclosure.

**Observation #3:**

- BS is the only investment bank who discloses the weighted average holding period of retained interests prior to being sold off (see below):

“Retained interests in securitizations are generally not held to maturity and typically are sold shortly after the settlement of a securitization. The weighed average holding period for retained interest positions in inventory at August 31, 2006 and November 30, 2005 was approximately 120 days and 90 days, respectively.”

**Recommendation:**

- Jim Guarino and Joe Sapia strongly recommend that we do not disclose the holding period of our retained interests.

**Observation #4:**

- LB is the only firm who discloses “interests in securitizations” versus retained interests. It is not apparent in our competitors' disclosures, but we believe that the difference is due to LB being the only firm to include interests purchased in secondary markets. GS discloses these interests in a separate paragraph and also excludes these amounts from their stress test.
- LB is the only investment bank that breaks out the stress test between investment grade and non investment grade residential mortgages while the rest of the firms show an aggregate disclosure.
- GS performs the stress test on hard to value retained interests only and excludes interests purchased in secondary markets as well as retained interests valued using quoted market prices in active markets.

**Recommendation:**

- Would like to follow up with our contacts at other firms and try to verify if the above is true. If so, may want to re-discuss what is being included in this disclosure.

**Observation #5:**

- ML, MS and BS have additional cautionary statements on their stress test.

**Recommendation:**

- Include additional caveats in both LB's interests in securitization and MSR stress tests. (see proposed wording below)

Proposed Wording (see sections in bold)

The sensitivity analysis is hypothetical and should be used with caution since the stresses are performed without considering the effect of hedges, which serve to reduce our actual risk. These results are calculated by stressing a particular economic assumption independent of changes in any other assumption (as required by U.S. GAAP); in reality, changes in one factor often result in changes in another factor **which may counteract or magnify the effect of the changes outlined in the above table**. Changes in the fair value based on a 10% or 20% variation in an assumption should not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. **In addition, the sensitivity analysis does not consider any corrective action that we may take to mitigate the impact of any adverse changes in these assumptions.**

**Observation #6:**

- BS discloses cash flows received from servicing for Agency Mortgage Backed and Other Mortgage and Asset Backed securitizations in tabular form. LB discloses the cash flows received from servicing the mortgage loans as one line "contractual servicing fees received".

**Recommendation:**

- Recommend that we clarify this section to "Cash flows received on contractual servicing in 2006 were approximately \$XX million and are classified as Principal Transactions in the Consolidated Statement of Income." Would not recommend breaking out cash flows from servicing between IG and NIG.

**Observation #7:**

- BS breaks down their MSR stress test into sub prime, fixed rate prime and adj rate prime in tabular form.

**Recommendation:**

- Do not recommend as do not think this gives additive value to reader. Jim and Joe both concur.

**Observation #8:**

- ML includes the amount of net securitization gains in their 10Q/K while MS discloses that their net securitization gains are “not material”.

**Recommendation:**

- Jim recommends that we do not disclose this amount as LB marks the securitization portfolio to market and there should really be no significant gain or loss at the time of securitization [open issue to discuss with E&Y].

**Observation #9:**

- BS discloses the call options on securitized transactions as follows:

“The Company has retained call options on a limited number of securitization transactions that require the Company to continue recognizing the assets subject to the call options. The total assets in these transactions approximated \$11.2 billion and \$8.7 billion, at August 31, 2006 and November 30, 2005, respectively.”

**Recommendation:**

- Per Jim, call options on securitized transactions are not applicable to LB.

**Observation #10:**

- ML is the only investment bank to disclose the principal amount outstanding, delinquencies and credit losses related their securitized financial assets (see attached Exhibit #1). MS and BS do not disclose their credit loss amounts but they do tell the reader that the credit losses on retained interests are not material.

**Recommendation:**

- Per Jim, LB discloses these amounts in the Pro Supp (Prospectus Supplement) which is updated every six months. Recommend including disclosure of credit losses on retained interest after the stress test table in our footnote. If the balance is not material we can consider stating as such rather than disclosing the actual balance.

**Observation #11:**

- ML includes disclosure that the investors have no recourse to other assets of the company if the mortgage holder defaults on the loan.

**Recommendation:**

- Discussed with Jim, this is applicable to LB. We recommend including the following disclosure below LB's stress test table:

“For residential mortgage loan and other securitizations, the investors and the securitization trust generally have no recourse to our other assets for failure of mortgage holders to pay when due.”

**Observation #12:**

- GS provides significant disclosures related to VIEs which include what comprises the Company's VIEs, transactions related to VIEs and asset detail of VIEs and respective maximum exposure to loss in tabular form (see attached Exhibit #2).

**Recommendation:**

- Recommend that we do not provide as much detail as our VIEs do not fall into as many different categories (primarily in real estate investments), and we disclose other related information in our Commitments and Contingencies footnote.

**Merrill Lynch - Delinquencies and Credit Losses Table**

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**Exhibit #2***(1 of 2)***Goldman Sachs – VIE Assets and Maximum Exposure**

The following table sets forth the firm's total assets and maximum exposure to loss associated with its significant variable interests in consolidated VIEs where the firm does not hold a majority voting interest. The firm has aggregated consolidated VIEs based on principal business activity, as reflected in the first column.

	<u>As of August 2006</u>		<u>As of November 2005</u>	
	<u>VIE Assets <sup>(1)</sup></u>	<u>Maximum Exposure to Loss</u>	<u>VIE Assets <sup>(1)</sup></u>	<u>Maximum Exposure to Loss</u>
	(in millions)			
Investments in loans and real estate	\$1,788	\$ 637	\$2,081	\$ 717
Municipal bonds	2,568	2,568	1,587	1,587
Mortgage-backed and other asset-backed	457	117	522	55
Asset repackagings and credit-linked notes	1,246	929	1,266	880
Investments in preferred stock	425	244	416	221
Foreign exchange and commodities	554	412	600	205
Other	150	286	152	279
Total	<u>\$7,188</u>	<u>\$5,193</u>	<u>\$6,624</u>	<u>\$3,944</u>

<sup>1)</sup> Consolidated VIE assets include assets financed by nonrecourse short-term and long-term debt. Nonrecourse debt is debt that only the issuing subsidiary or, if applicable, a subsidiary guaranteeing the debt is obligated to repay.

**Exhibit #2**  
(2 of 2)

The following tables set forth total assets in nonconsolidated VIEs in which the firm holds significant variable interests and the firm's maximum exposure to loss associated with these interests. The firm has aggregated nonconsolidated VIEs based on principal business activity, as reflected in the first column. The nature of the firm's variable interests can take different forms, as described in the columns under maximum exposure to loss.

As of August 2006						
Maximum Exposure to Loss in Nonconsolidated VIEs						
VIE Assets	Purchased and Retained Interests	Commitments and Guarantees	Derivatives <sup>(1)</sup>	Loans and Investments	Total	
	(in millions)					
Collateralized debt obligations	\$ 40,916	\$ 2,170	\$ —	\$ 9,439	\$ —	\$ 11,609
Asset repackagings and credit-linked notes	4,778	—	—	3,237	—	3,237
Power-related	3,398	2	73	—	618	693
Investments in loans and real estate	14,086	—	34	15	1,658	1,707
Mortgage-backed and other asset-backed	4,714	62	1,256	63	260	1,641
Total	\$ 67,892	\$ 2,234	\$ 1,363	\$ 12,754	\$ 2,536	\$ 18,887

As of November 2005						
Maximum Exposure to Loss in Nonconsolidated VIEs						
VIE Assets	Purchased and Retained Interests	Commitments and Guarantees	Derivatives <sup>(1)</sup>	Loans and Investments	Total	
	(in millions)					
Collateralized debt obligations	\$ 24,295	\$ 780	\$ —	\$ 4,536	\$ —	\$ 5,316
Asset repackagings and credit-linked notes	2,568	—	—	1,527	—	1,527
Power-related	6,667	2	95	—	1,070	1,167
Investments in loans and real estate	14,232	—	11	—	1,082	1,093
Mortgage-backed and other asset-backed	6,378	208	248	52	426	934
Total	\$ 54,140	\$ 990	\$ 354	\$ 6,115	\$ 2,578	\$ 10,037

<sup>(1)</sup> Derivatives related to CDOs consist of total return swaps on investment-grade securities issued by VIEs as well as out-of-the-money written put options that provide protection on investment-grade collateral held by VIEs. Derivatives related to asset repackagings and credit-linked notes consist of out-of-the-money written put options that provide principal protection on notes issued by VIEs. Neither the total return swaps nor the written put options expose the firm to a majority of the VIE's expected losses or expected residual returns.

## Commitments, Contingencies and Guarantees

### COMMITMENTS

- Captions for commitments used by the five investment banks are as follows (footnotes on next page):

	<u>LEH</u>	<u>GS</u>	<u>MER</u>	<u>MS</u>	<u>BSC</u>
○ Commitments (quantitative disclosure):					
High-grade lending	✓		✓	✓	✓
High-yield lending	✓		✓	✓	✓
Total lending <sup>(1) (2)</sup>		✓			
Binding margin lending			✓		
Mortgage lending <sup>(1)</sup>	✓	✓	✓		✓
Investment-grade contingent acquisition facilities	✓	✓			✓
Non-investment-grade contingent acquisition facilities	✓	✓			✓
Total contingent acquisition facilities <sup>(3)</sup>			✓	✓	
Secured lending	✓	✓	✓	✓	
Construction <sup>(4)</sup>		✓			
Market data, communications, and systems consulting services <sup>(4)</sup>			✓		
Other purchase <sup>(4)</sup>		✓	✓		✓
Letters of credit (issued by commercial banks to counterparties to satisfy various collateral and margin deposit requirements) <sup>(5)</sup>		✓		✓	✓
Private equity and other principal investments <sup>(5)</sup>		✓	✓	✓	✓
Underwriting of mortgage-backed securitizations and fixed income underwriting					✓
Total lease obligations <sup>(6)</sup>	✓	✓	✓	✓	✓
Credit card receivable purchases					✓

- (1) GS includes mortgage lending in their “warehouse financing” line. MER has a footnote entirely devoted to their lending-related commitments, including mortgages.
- (2) GS discloses their total lending commitment and state that “substantially” all of them are to investment-grade corporate borrowers.
- (3) MS and MER do not disclose contingent acquisitions separately, the amount is included in their lending-commitment amount. GS includes their contingent acquisitions in their “Other commercial lending commitments” section.
- (4) Represents commitments not related to trading activities.
- (5) LEH discloses in table “Other commitments and guarantees.”
- (6) LEH is the only firm that discloses total lease obligations broken out by capital lease and operating lease. All other firms disclose total lease obligations.

**Observation #1:**

- GS and MER organize their footnote into three main sections: “Commitments”, “Contingencies” and “Guarantees”. MS and BSC have a footnote for “Commitments and contingencies” and a separate footnote for “Guarantees”. LEH has a footnote that is organized into four main sections: “Lending-related commitments”, “Other commitments and guarantees”, “Litigation” and “Lease commitments”.

**Recommendation:**

- Continue with the current footnote presentation. We currently only disclose one type of guarantee (FIN 45 derivatives) in a tabular format and it would look odd to have a table with only one row. If in the future we add more guarantees to be disclosed in a tabular format, then we may reconsider reorganizing the footnote.

**Observation #2:**

- LEH is the only firm that has a maturity table or discloses maturity information for commitments in the footnote.

**Consideration:**

- Remove the maturity disclosure from the footnote and only show the maturity disclosure in the MD&A.

**Observation #3:**

- LEH is the only firm disclosing future rental commitments by operating and capital lease in the footnote and MD&A.

**Recommendation:**

- Present future minimum rental commitments for total leases not broken out by operating lease/capital leases.

**Observation #4:**

- MER discloses the amount of their purchase commitment as follows:
  - “Merrill Lynch entered into commitments to purchase loans of \$3.3 billion (\$3.2 billion of which may be included in trading assets and \$96 million of which may be included in loans, notes, and mortgages) at December 30, 2005. Such commitments totaled \$1.6 billion at December 31, 2004.”
- BSC discloses that their mortgage commitment amount includes commitments to purchase mortgages:
  - “The Company participates in the acquisition, securitization, servicing, financing and disposition of commercial and residential loans. At November 30, 2005 and 2004, the Company had entered into commitments to purchase or finance mortgage loans of \$5.1 billion and \$1.2 billion, respectively.”

**Recommendation:**

- Include the amount for commitments to purchase mortgages in the mortgage commitment amount. We may then need to consider whether we can still call the section “Lending-related commitments”. Re-word the mortgage commitments section as follows (changes in bold):

*“Mortgage commitments.* Through our mortgage origination platforms we make commitments to extend **and purchase** mortgage loans. We use various hedging and funding strategies to actively manage our market, credit and liquidity exposures on these commitments. We do not believe total commitments necessarily are indicative of actual risk or funding requirements because the commitments may not be drawn or fully used and such amounts are reported before consideration of hedges. At November 30, 2006 and November 30, 2005, we had outstanding mortgage commitments of approximately \$● billion and \$9.4 billion, respectively, including \$● billion and \$7.7 billion of residential mortgages and \$● billion and \$1.7 billion of commercial mortgages. ~~The residential mortgage loan commitments require us to originate mortgage loans at the option of a borrower generally within 90 days at fixed interest rates.~~ We sell residential mortgage loans, once originated, primarily through securitizations.

See Note 3 to the Consolidated Financial Statements for additional information about our securitization activities.”

**Observation #5:**

- MER disclosed binding margin lending as follows:
  - “In the normal course of business, Merrill Lynch enters into institutional and margin-lending transactions, some of which are on a committed basis, but most of which are not. Margin lending on a committed basis only includes amounts where Merrill Lynch has a binding commitment. These binding margin lending commitments totaled \$381 million at December 30, 2005 and \$303 million at December 31, 2004.”

**Recommendation:**

- Currently examining if we have this type of commitment.

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**Observation #6:**

- BSC disclosed underwriting commitment as follows:

“In connection with the Company’s mortgage-backed securitizations and fixed income underwriting, the Company had commitments to purchase new issues of securities aggregating \$943.1 million and \$418.2 million, respectively, at November 30, 2005 and 2004.”

**Recommendation:**

- No change to be made. We view as unsettled trade date purchases and therefore not separately disclosed.

**OTHER COMMITMENTS AND GUARANTEES**

- Captions for other commitments and guarantees used by the five investment banks are as follows:

	<u>LEH</u>	<u>GS</u>	<u>MER</u>	<u>MS</u>	<u>BSC</u>
○ Other commitments and guarantees (quantitative disclosure):					
Derivatives <sup>(1) (2)</sup>	✓	✓	✓	✓	✓
Municipal-securities-related	✓				✓
Other commitments with SPEs <sup>(4)</sup>	✓	✓	✓	✓	
Standby letters of credit and other guarantees issued directly to counterparties <sup>(3)</sup>		✓	✓		
Standby letters of credit (issued by commercial banks to counterparties to satisfy various collateral and margin deposit requirements)	✓				
Private equity and other principal investment <sup>(3)</sup>	✓	✓			
Securities lending indemnifications		✓			
Guarantees of the collection of contractual cash flows <sup>(3)</sup>		✓			
General partner guarantees (clawbacks)				✓	
Merchant chargeback guarantees <sup>(5)</sup>				✓	
Lease residual value			✓		✓

- (1) MS, BSC and MER state that the notional amount of written interest rate caps and written foreign currency options are being disclosed instead of maximum payout because maximum payout can't be calculated in these types of contracts due to the potential movement in interest rates and foreign exchange rates and the fact that these contracts don't have caps for these movements. LEH states that notional amounts are disclosed for all derivative guarantees.
- (2) In their 3Q06 10-Q, GS disclosed the gross asset and liability amounts that were used to calculate the fair value of the derivatives guarantee.
- (3) GS consolidated these three lines into "Other financial guarantees" in their 3Q06 10-Q.
- (4) Includes market value guarantees made by MS to certain European equity funds and guarantees of trust preferred beneficial interests made by GS.
- (5) Relates to MS' credit card business.

**Observation #7:**

- LEH is the only firm presenting a maturity table with five maturity periods: 2006, 2007, 2008-2009, 2010-2011 and 2012-later. GS presents the following four maturity periods: 2006, 2007-2008, 2009-2010 and 2011-thereafter. The other firms also present four maturity periods as follows: less than one year, one to three years, three to five years and greater than five years.

**Recommendation:**

- No change recommended. It is our understanding that the maturity dates disclosed are made as a request from either senior management or a member of the Board.

**Observation #8:**

- GS disclosed their guarantee related to collection of contractual cash flows as follows:  
“In connection with certain asset sales and securitization transactions, the firm guarantees the collection of contractual cash flows.”

**Recommendation:**

- No disclosure to be added per discussion with PC.

**Observation #9:**

- MS disclosed their guarantee related to general partnerships as follows:  
“As a general partner in certain private equity and real estate partnerships, the Company receives distributions from the partnerships according to the provisions of the partnership agreements. The Company may, from time to time, be required to return all or a portion of such distributions to the limited partners in the event the limited partners do not achieve a certain return as specified in various partnership agreements, subject to certain limitations. The maximum potential amount of future payments that the Company could be required to make under these provisions at November 30, 2005 and November 30, 2004 was \$349 million and \$265 million, respectively. As of November 30, 2005 and November 30, 2004, the Company’s accrued liability for distributions that the Company has determined it is probable it will be required to refund based on the applicable refund criteria specified in the various partnership agreements was \$36 million and \$68 million, respectively.”

**Recommendation:**

- Currently examining whether we make this guarantee.

**NON-QUANTITATIVE DISCLOSURES**

- Captions for non-quantitative disclosures used by the five investment banks are as follows:

	<u>LEH</u>	<u>GS</u>	<u>MER</u>	<u>MS</u>	<u>BSC</u>
○ Non-quantitative disclosures:					
Litigation	✓	✓	✓	✓	✓
Guarantees to securities clearing houses and exchanges	✓	✓	✓	✓	✓
Guarantees to third party service providers and to customers for losses from third-party service providers		✓			
Asset sales and securitization representations and warranties	✓		✓	✓	✓
Securities and other inventory position sold but not yet purchased	✓			✓	
Credit and market risk related to customer transactions	✓		✓		
General partner related	✓			✓	
Representations/warranties in connection with commercial transactions		✓	✓		✓
Indemnifications related to adverse changes in tax laws and for taxes on interest payments and securities transactions		✓	✓	✓	✓
European M&A transaction guarantees			✓	✓	

**Observation #10:**

- GS has wording related to the calculation of the maximum payout of guarantees and indemnifications as shown below:

“In the normal course of its business, the firm indemnifies and guarantees certain service providers such as clearing and custody agents, trustees and administrators against specified potential losses in connection with their acting as an agent of, or providing services to, the firm or its affiliates. The firm also indemnifies some clients against potential losses incurred in the event specified third-party service providers including sub-custodians and third-party brokers, improperly execute transactions. The firm is unable to develop an estimate of the maximum payout under these guarantees and indemnifications. However, management believes that it is unlikely the firm will have to make any material payments under these arrangements, and no liabilities related to these guarantees and indemnifications have been recognized in the consolidated statements of financial condition as of November 2005 and November 2004.”

**Recommendation:**

- Consider adding the wording below:

“In the normal course of business, the firm indemnifies and guarantees certain service providers such as clearing and custody agents, trustees and administrators against specified potential losses in connection with their acting as an agent of, or providing services to, the firm or its affiliates. The firm also indemnifies some clients against potential losses incurred in the event specified third-party service providers including sub-custodians and third-party brokers, improperly execute transactions. The firm is unable to develop an estimate of the maximum payout under these guarantees and indemnifications. However, management believes that it is unlikely the firm will have to make any material payments under these arrangements, and no liabilities related to these guarantees and indemnifications have been recognized in the Consolidated Statements of Financial Condition as of November 2006 and November 2005.”

**Observation #11:**

- LEH's competitors disclose indemnifications related to tax trades and changes in tax laws. See attachment A for GS and attachment B for MS.

**Consideration:**

- Add the following wording in the "Other" section of the footnote:

"In the normal course of business we routinely indemnify investors for certain taxes, including U.S. and foreign withholding taxes on interest and other payments made on securities, derivatives and other financial arrangements. These additional payments would be required upon a change in law or interpretation thereof. Our maximum exposure under these indemnifications is not quantifiable and we believe the potential for such an adverse change is remote. As such, no liability is recorded in the Consolidated Statement of Financial Condition. We also provide indemnifications related to the U.S. tax treatment of certain foreign tax planning transactions. We believe the likelihood of loss with respect to these arrangements is remote."

**Critical Accounting Policies and Estimates (in MD&A)**

	<u>LEH</u>	<u>GS</u>	<u>MER</u>	<u>MS</u>	<u>BSC</u>
○ Discussions about:					
Fair value of financial instruments	✓	✓	✓	✓	✓
Derivatives	✓	✓	✓	✓	✓
Cash instruments	✓	✓	✓	✓	✓
Mortgages, mortgage-backed and real estate	✓			✓	✓
High yield	✓		✓ <sup>1</sup>	✓	✓
Private equity and other principal investments	✓	✓		✓	✓
Non-investment grade interests in securitizations	✓				
Identifiable intangible assets and goodwill	✓	✓			
SPEs (QSPE and VIE)	✓		✓		
Legal, regulatory, and tax contingencies	✓	✓	✓	✓	✓
Controls over valuation of financial instruments		✓		✓	✓
Use of estimates - overall		✓	✓		
Allowance for consumer loan losses				✓	
Income taxes			✓		
○ Tables that present:					
Summary balance sheet	✓		✓		
Financial instruments by category		✓			
Cash instruments by price transparency		✓	✓	✓	✓
Fair value of derivatives by product and maturity	✓	✓		✓ <sup>2</sup>	
Net Credit Exposure	✓	*	*	*	*
Breakdown of exchange traded and OTC derivative assets/liabilities	*	✓		✓	
Public and private principal investments broken down into corporate and real estate		✓			
Carrying value of goodwill by operating segment		✓			
Carrying value and remaining useful lives of each class of identifiable intangible asset		✓			

**Notes:**

<sup>1</sup> – Discussion in a separate section of MD&A.

<sup>2</sup> – Table present in item # 3 – Quantitative and Qualitative Disclosure about Market Risk.

\* – Available in 10-K, but not in this section.

1/22/2010

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## **FINANCIAL INSTRUMENTS**

- **Observation #1:**

- Merrill Lynch (ML) categorizes assets and liabilities into three groups based on liquidity/pricing transparency and amount of estimation required in determining its value.
- Goldman Sachs (GS) describes the valuation of their cash trading assets in terms of “price transparency”. Additionally, GS provides a “Cash Trading Instruments by Price Transparency” table that segregates their cash trading instruments into two classes: marketable and non-marketable.

- **Recommendation:**

- Lehman Brothers (LB) will address the effects of SFAS No. 157, *Fair Value Measurements* in the first quarter of FYE 2007. Therefore, we do not recommend including this disclosure in our 2006 year end financial statements.

- **Observation #2:**

- MS dedicates a paragraph explaining what factors affect price transparency which determines the degree of judgment when determining fair value. This paragraph is in addition to the description of valuation of each respective instrument described in the section.

- **Recommendation:**

- We recommend that LB includes an introductory paragraph that describes the considerations and external factors that may influence financial instrument valuation as shown by MS:

“The price transparency of the particular product will determine the degree of judgment involved in determining the fair value of the Company’s financial instruments. Price transparency is affected by a wide variety of factors, including, for example, the type of product, whether it is a new product and not yet established in the marketplace, and the characteristics particular to the transaction. Products for which actively quoted prices or pricing parameters are available or for which fair value is derived from actively quoted prices or pricing parameters will generally have a higher degree of price transparency. By contrast, products that are thinly traded or not quoted will generally have reduced to no price transparency. Even in normally active markets, the price transparency for actively quoted instruments may be reduced for periods of time during periods of market dislocation. Alternatively, in thinly quoted markets, the participation of market-makers willing to purchase and sell a product provides a source of transparency for products that otherwise are not actively quoted or during periods of market dislocation.”

- **Observation #3:**
  - GS and MS breakout derivatives by exchange traded and OTC traded into tabular format. – **See Exhibits #1 and #2.**
- **Consideration:**
  - LB discusses the segregation of derivatives by exchange traded and OTC traded in the paragraph preceding the OTC traded table. We should consider disclosing this information in tabular form if we believe this will be more helpful.
- **Observation #4:**
  - BS categorizes the valuation of financial instruments into three broad groups: independent external valuations, internal valuations from readily observable and objective sources and internal valuations from less readily observable and objective sources. BS has an ongoing internal review of its valuation of financial instruments. Members of the Controllers and Risk Management Departments perform analysis of the internal valuation. Results of the internal valuation are reported to the “Mark-to-Market” Committee, comprised of senior management of the Controllers and Risk Managements Departments. This Committee is responsible for ensuring that the approaches used to independently validate the Company’s valuations are robust, comprehensive, and effective.
  - GS and MS discuss their controls over valuation of financial instruments, but both firms do not discuss a committee like BS.
- **Recommendation:**
  - LB has a sentence describing their controls over valuation of financial instruments. We recommend that LB expands its discussion of its controls. This discussion will better enable the reader to understand how LB monitors and reviews their valuation methodology. – **See Exhibits #3 and #4.**

#### **IDENTIFIABLE INTANGIBLE ASSETS AND GOODWILL**

- **Observation #5:**
  - GS discloses the significant acquisitions that comprise goodwill and identifiable intangible assets. Additionally, GS discusses the test of impairment and provides a table of Goodwill and Identifiable Intangible Assets separately. GS also discusses the external factors or events that may cause an impairment.
- **Recommendation:**
  - LB dedicates one paragraph on this topic giving a brief description of the considerations for recording and maintaining these assets on the books. LB also discloses the last impairment test performed and the test’s conclusion. We do not recommend inserting a table or expanding the discussion of Goodwill or Identifiable Intangible Assets, similar to what GS has done.

### LEGAL, REGULATORY, AND TAX CONTINGENCIES

- **Observation #6:**
  - MS and Bear Stearns (BS) are more expansive in their discussion of legal, regulatory, and tax contingencies.
- **Recommendation:**
  - We recommend that LB changes their current caption of “Legal Reserves” to “Legal, Regulatory, and Tax Contingencies”. We currently state that legal, regulatory, and tax considerations are covered, though only discuss legal in any detail.
  - We recommend that we expand our tax discussion and include a discussion, perhaps including here the new income tax disclosure added in the commitments section related income tax reserves.
  - We recommend expanding our regulatory discussion as shown by MS:

“Reserves for litigation and regulatory proceedings are generally determined on a case-by-case basis and represent an estimate of probable losses after considering, among other factors, the progress of each case, prior experience and the experience of others in similar cases, and the opinions and views of internal and external legal counsel.”

### USE OF ESTIMATES - OVERALL

- **Observation#7:**
  - ML presents “Use of Estimates” as an introduction to the section in a bullet point format. – **See Exhibit #5.**
- **Recommendation:**
  - LB discusses the use of estimates as an introduction to this section. We recommend that we do not change this presentation as we do not think it adds value.

**Goldman Sachs – Breakout Derivatives by Exchange Traded and OTC Traded**

The following table sets forth the fair value of our exchange-traded and OTC derivative assets and liabilities:

	<b>Derivative Assets and Liabilities</b> (in millions)			
	<b>As of August 2006</b>		<b>As of November 2005</b>	
	<b>Assets</b>	<b>Liabilities</b>	<b>Assets</b>	<b>Liabilities</b>
Exchange-traded derivatives	\$ 11,735	\$ 10,681	\$ 10,869	\$ 9,083
OTC derivatives	48,446	46,515	47,663	48,746
<b>Total</b>	<b>\$ 60,181 <sup>(1)</sup></b>	<b>\$ 57,196 <sup>(2)</sup></b>	<b>\$ 58,532 <sup>(1)</sup></b>	<b>\$ 57,829 <sup>(2)</sup></b>

<sup>(1)</sup> Net of cash received pursuant to credit support agreements of \$22.24 billion and \$22.61 billion as of August 2006 and November 2005, respectively.

<sup>(2)</sup> Net of cash paid pursuant to credit support agreements of \$17.27 billion and \$16.10 billion as of August 2006 and November 2005, respectively.

Morgan Stanley – Breakout Derivatives by Exchange Traded and OTC Traded

The following table presents the fair value of the Company's exchange traded and OTC derivatives included within Financial instruments owned and Financial instruments sold, not yet purchased (dollars in millions):

	At August 31, 2006		At November 30, 2005	
	Assets	Liabilities	Assets	Liabilities
Exchange traded	\$ 9,065	\$ 13,672	\$ 4,491	\$ 8,151
OTC	39,688	33,345	41,403	36,801
Total	<u>\$ 48,753</u>	<u>\$ 47,017</u>	<u>\$ 45,894</u>	<u>\$ 44,952</u>

**Goldman Sachs – Controls Over Valuation of Financial Instruments**

A control infrastructure, independent of the trading and investing functions, is fundamental to ensuring that our financial instruments are appropriately valued and that fair value measurements are reliable. This is particularly important in valuing instruments with lower levels of price transparency.

We employ an oversight structure that includes appropriate segregation of duties. Senior management, independent of the trading functions, is responsible for the oversight of control and valuation policies and for reporting the results of these policies to our Audit Committee. We seek to maintain the necessary resources to ensure that control functions are performed to the highest standards. We employ procedures for the approval of new transaction types and markets, price verification, review of daily profit and loss, and review of valuation models by personnel with appropriate technical knowledge of relevant products and markets. These procedures are performed by personnel independent of the revenue-producing units. For trading and principal investments with little or no price transparency, we employ, where possible, procedures that include comparisons with similar observable positions, analysis of actual to projected cash flows, comparisons with subsequent sales and discussions with senior business leaders. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Management” in Part II, Item 7 of the Annual Report on Form 10-K for a further discussion on how we manage the risks inherent in our trading and principal investing businesses.

**Morgan Stanley – Controls Over Valuation of Financial Instruments**

The Company employs control processes to validate the fair value of its financial instruments, including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable market prices or market-based parameters wherever possible. In the event that market prices or parameters are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and that the assumptions are reasonable. These control processes include reviews of the pricing model's theoretical soundness and appropriateness by Company personnel with relevant expertise who are independent from the trading desks. Additionally, groups independent from the trading divisions within the Financial Control and Market Risk Departments participate in the review and validation of the fair values generated from pricing models, as appropriate. Where a pricing model is used to determine fair value, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model. Consistent with market practice, the Company has individually negotiated agreements with certain counterparties to exchange collateral ("margining") based on the level of fair values of the derivative contracts they have executed. Through this margining process, one party or both parties to a derivative contract provides the other party with information about the fair value of the derivative contract to calculate the amount of collateral required. This sharing of fair value information provides additional support of the Company's recorded fair value for the relevant OTC derivative products. For certain OTC derivative products, the Company, along with other market participants, contributes derivative pricing information to aggregation services that synthesize the data and make it accessible to subscribers. This information is then used to evaluate the fair value of these OTC derivative products. For more information regarding the Company's risk management practices, see "Quantitative and Qualitative Disclosures about Market Risk—Risk Management" in Part II, Item 7A of the Form 10-K.

**Merrill Lynch – Use of Estimates**

In presenting the Condensed Consolidated Financial Statements, management makes estimates regarding:

- Valuations of assets and liabilities requiring fair value estimates including:
  - Trading inventory and investment securities;
  - Private equity investments;
  - Loans and allowance for loan losses;
- The outcome of litigation;
- The realization of deferred tax assets and tax reserves;
- Assumptions and cash flow projections used in determining whether variable interest entities (“VIEs”) should be consolidated and the determination of the qualifying status of special purpose entities (“QSPEs”);
- The carrying amount of goodwill and other intangible assets;
- Valuation of employee stock options;
- Insurance reserves and recovery of insurance deferred acquisition costs;
- Interim compensation and benefits accruals, particularly cash and stock incentive awards and FA compensation; and
- Other matters that affect the reported amounts and disclosure of contingencies in the financial statements.

## Employee Incentive Plans and FASB 123R Disclosures

- The five investment banks provide disclosures of SFAS 123R in the following footnotes:

	<u>LEH</u>	<u>GS</u>	<u>MER</u>	<u>MS</u>	<u>BSC</u>
Effect of the Adoption of SFAS 123(R)	4	4	2	4	4
Effect of SFAS 123(R) on retirement eligible employees	1	4	3	4	-
Effect of SFAS 123(R) on estimated forfeitures of stock options	2	4	2	4	-
Effect of SFAS 123(R) on cash dividends paid for restricted stock units	-	4	-	-	-
New disclosure under SFAS 123(R) tax benefits in the Cash flow statement	2	4	2	-	-
New disclosure under SFAS 123(R) equity for unamortized employee stock grants	2	-	2	-	-
New disclosure under 123(R) total intrinsic value of stock options exercised	1	1	1	-	-
New disclosure under 123(R) total intrinsic value of vested stock options	1	-	1	-	-

1 – It is disclosed in the “Share-Based Employee incentive plan” footnote

2 – It is disclosed in Footnote 1 under “Accounting changes and other accounting developments”

3 - It is disclosed in Footnote 1 under “Accounting changes and other accounting developments” and in the “Share-Based Employee incentive plan” footnote.

4 – It is disclosed in Footnote 1 under “Significant accounting policies – Share based compensation”.

**Based on analysis see Observations and recommendations for the following footnotes listed below (attached)**

Share-Based Employee incentive plan

Significant accounting policies – Share based compensation

Accounting changes and other accounting developments

## **Share Based - Employee Incentive Plans**

**Due to the implementation of 123R in the 1<sup>st</sup> qtr of 2006 there are certain disclosures in the 2006 LEH 10Q's that were not in the LEH 2005 10K that will be added in for year-end.**

- Incentive plan footnotes vary among the five investment banks depending on the nature of each bank's plan.
- There was no separate "Employee Incentive Plan" footnote in the BS and MS 10Q. Anything they disclose is in the "Significant Accounting Policies" footnote.

### **Observation #1:**

- The disclosure following the stock option activity table does not state that it "includes stock options granted to employees subsequent to year end as part of year-end compensation".
- Verified with Dina Korda that there are options granted to named executives in the proxy subsequent to FYE that relate to current year performance.

### **Recommendation:**

- None, we do not expect to meet "grant date" definition of 123R for 2006 grants after year-end.

### **Observation #2:**

- The GS and ML 10Q's disclose RSU's outstanding by those that require future service and those that do not require future service, along with the weighted average grant date fair value (due to retirement eligible employees) (see attachments).

### **Recommendation:**

- Disclose RSU's outstanding by those that require future service and those that do not require future service along with the weighted average grant date fair value.

### **Observation # 3:**

- Noted from Accounting Policy department, there is a new disclosure required in the financials that discloses the Black-Scholes assumptions for named executives in the proxy.

### **Recommendation:**

- Insert disclosure in a sentence (as to not highlight) below the Black-Scholes assumptions table currently shown in the 10Q. (See attachment).

**Significant accounting policies – “Share-based Compensation” and “Accounting Changes and Other Accounting Developments”**

**Due to the implementation of 123R in the 1<sup>st</sup> qtr of 2006 there are certain disclosures in the 2006 LEH 10Q’s that were not in the LEH 2005 10K that will be added in for year-end.**

**Observation # 1:**

- LEH is the only bank that discloses the effects of 123R in three different sections on the 10Q (“Share-based compensation”, “Accounting changes and other accounting developments” and “Share-based employee incentive plans”).

**Recommendation:**

- No change.

**Observation # 2:**

- There were several disclosures that were on the competitors 10Q’s that were not disclosed in the LEH 10Q’s.

**Recommendation:**

**GS disclosure -**

The firm pays cash dividend equivalents on outstanding restricted stock units. Dividend equivalents paid on restricted stock units accounted for under SFAS No. 123 and SFAS No. 123-R are charged to retained earnings when paid. SFAS No. 123-R requires dividend equivalents paid on restricted stock units expected to be forfeited to be included in compensation expense. Prior to the adoption of SFAS No. 123-R, dividend equivalents paid on restricted stock units that were later forfeited by employees were reclassified to compensation expense from retained earnings. Dividend equivalents paid on restricted stock units granted prior to 2003 were accounted for under APB Opinion No. 25 and charged to compensation expense.

**Proposed Lehman Brothers Disclosure -**

Our equity-based employee award plans provide for the accrual of non-cash forfeitable dividend equivalents on outstanding restricted stock units. These dividend equivalents on restricted stock units are charged to retained earnings as declared. (adopted from LEH Q3 2005 10Q)

## **Securities Received and Pledged as Collateral**

### **Observation #1:**

- ML and MS disclose in a table by classification the carrying value of securities that have been pledged to counterparties where those counterparties do not have the right to sell or repledge.

### **Recommendation:**

- None, but can discuss merits of including table discussed in above observation.

### **Observation #2:**

- ML discloses that it “may use securities received as collateral for resale agreements to satisfy regulatory requirements such as Rule 15c3-3 of the SEC. At ● 2006 and ● 2005, the fair value of collateral used for this purpose was ● and ●, respectively.”

### **Consideration:**

- Larry Nazimowitz and Bill Burke are discussing the value added by the disclosure and whether it would be feasible to obtain the necessary information required in the disclosure. Larry also noted that LEH uses more than just repos.