

From: Vecchio, Laura M <LVecchio@lehman.com>
Sent: Friday, February 8, 2008 3:03 PM (GMT)
To: Callan, Erin <ecallan@lehman.com>; Kelly, Martin <martin.kelly@lehman.com>; O'Meara, Chris M (NY) <comeara@lehman.com>; Rudofker, Beth <brudofke@lehman.com>
Cc: Liu, Fong <fong.liu@lehman.com>; Shotton, Paul <paul.shotton@lehman.com>; Leng, Manhua <mleng@lehman.com>; Yu, Anna <anna.yu@lehman.com>; Rossi, Stephen F <stephen.rossi@lehman.com>; Stucchio, Anthony <astucchi@lehman.com>; Tringali, James <jtringal@lehman.com>; Goodman, Jeffrey <jeffrey.goodman@lehman.com>
Subject: Holistic Trading Book Migration & Approval
Attach: ole1.bmp;Holistic Trading Book 2-7-08.Final.ppt

All,

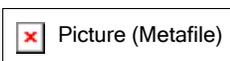
Yesterday a group of us met with the SEC-Division Of Trading & Markets (Matt Eichner & team) to present and review our proposed approach for migrating off of Reg Y specific risk methodology to our internal methodology and models.

In summary:

- SEC plans on approving & permitting 3 of the 5 CSE firms to migrate to the new approach (presumably Goldman and Morgan are the other two)
- The proposal (attached) was very well received and approval from the SEC is expected relatively quickly

<<Holistic Trading Book 2-7-08.Final.ppt>>

- The Holistic Trading Book approach involves migrating methodology across 4 different areas for: (1) Corporates/EM/Munis use of JTD; (2) Principal Investments use of the Merton Model;
- (3) Securitized Products of JTG and (4) Market Neutral Strategies of Deal Break Risk
- The combined approaches if all of our recommended holding periods, Risk Weights and Confidence Levels are adopted would result in an approximate reduction in our current risk allowance of on average \$4B using pro-forma computations for Oct to Dec 2007 month end figures. These pro-forma results were included in the presentation to the SEC.
- We expect that our full recommendations will be approved but if there is push back on holding periods or other variables, we could end up with perhaps a slightly lower benefit (my guesstimate might be \$800MM lower)
- The net result of the migration to new methodologies would result in a reduction in RWA of approximately \$50B and allow for significant improvement in our Tier 1 and Total Risk Based Capital Ratios, using the same periods:



- Looking forward to February month end on a projected basis including the above methodology impact, revenues and recent plus anticipated debt issuance Anna Yu has projected a Total Risk Based Capital

Ration @ 2/29/08 of 14.2%.

Next Steps & Approval Conditions:

- We proposed be ready to implement the methodologies beginning Q2-2008 (some fully automated, others still somewhat manual in nature initially)
- Approval will undoubtedly contain caveats related to our ability to implement the proposed methodologies into LehmanRisk in a automated fashion with adequate internal control to ensure populations completeness
- In order to prepare the various firms migrating for anticipated questions which might arise during analyst calls and other meetings once ratios are released following Q2, the SEC has proposed sharing pro-forma RWA in advance for several months, anonymously amongst just the 3 firms and later on the additional 2 firms once they are approved. We need to get back to Matt Eichner within the next day or two to let him know if we are comfortable as a Firm sharing this pro-forma data as the SEC would start doing so as early as next week.
- Matt Eichner is going to coordinate and discuss the proposed approach and suggest simultaneous approval for LBI (and other legal entities) with Grace Vogel (FINRA) and will get back to us to let us know the outcome of that discussion

Additional Topics Covered:

- Matt Eichner also suggested two other areas of our internal Risk Methodology and CSE Capital Computation Methodology that we should review and discuss proposals with the SEC prior to Q2 release of CSE-Basel II Disclosures, if we are interested.
- The two areas are: (1) Our use of exponential weighting in VaR and our CSE capital methodology for Retained Interests.
- We currently treat non-rated and some below "BB" rated Retained Interest tranches as Banking Book and charge a 1250% RW against those positions, this represented approximately a \$2B risk allowance as of 11/30/07. The SEC indicated that our treatment is more punitive than other CSE firms and suggested that there is probably some portion of the Retained Interest portfolio for which we could recommend an appropriate trading book methodology and capital computation. Submitting such a proposal fairly quickly could also result in a significant capital allowance reduction and further improvement in capital ratios.

Good work and team effort by all involved towards a an excellent end result for the Firm.

Please do not hesitate to call me if you have any questions. I will update you as soon as we hear something further from Matt Eichner.

Thanks,
Laura