

Accounting Policy Review

Balance Sheet Netting and Other Adjustments

November 2007

LEHMAN BROTHERS

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I. Executive Summary

- This grid is the joint effort of the Balance Sheet Group and the Accounting Policy Group
 - ◆ Balance Sheet Group identified the netting and other adjustment items and provided the balance sheet net-down impact as of 2/28/07 and 11/30/06.
 - ◆ Accounting Policy Group reviewed each adjustment item and determined whether the current practice is in compliance with US GAAP.
 - ◆ Implementation action plans with respect to certain items are documented and attached in Appendix A.
- This grid contains balance sheet adjustments in the following three categories
 - ◆ Balance sheet netting
 - ◆ Exceptions to trade date accounting
 - ◆ Other balance sheet adjustments
- This grid does not cover
 - ◆ SFAS 140 prime brokerage gross-up
 - ◆ SFAS 140 QSPE and FIN 46(R) consolidation
 - ◆ STG netting
- Additional netting issues may arise in the future.

I. Executive Summary

- Overview of adjustment categories and balance sheet Impact:

Main Category	Description	Total Balance Sheet Impact (in billions)	
		2/28/07	11/30/06
All *		\$940 longs \$461 shorts	\$865 longs \$453 shorts
Balance sheet netting *	CUSIP netting, FIN 41 netting on repo and reverse repo agreements and derivatives netting under FIN 39, etc.	\$858 longs \$460 shorts	\$807 longs \$450 shorts
Exceptions to trade date accounting	Whole loan purchase commitments, forward purchases or sales of when-issued/pre-auction securities, GAWA and Hoffman trades, etc.	\$26 buys \$1 sells	\$16 buys \$3 sells
Other balance sheet adjustments	Repo 105/108, Repo Reinvest program, participation agreements, Repo to maturity, etc.	\$56	\$42

* not including two adjustment items: 1) prime broker receivables and payables (net-down amounts not available due to system limitations); and 2) FIN 41 repo and reverse repo netting under Chase settlement structure (netting started in February 07 and actual amount was minimal).

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
TBAs – derivatives – balance sheet adjustments	<p>To-be-announced or TBAs are delivery obligations on underlying collateral (i.e., mortgage pools) with pool numbers and precise amounts unknown at the trade date. In accordance with FAS 133.59(a), forward purchases or sales of securities that do not yet exist (such as TBAs or When Issued securities) are generally treated as derivative contracts, unless they meet the following criteria:</p> <ul style="list-style-type: none"> - There is no other way to purchase or sell that security; - Delivery of that security and settlement will occur within the shortest period possible for that type of security. - It is probable at inception and throughout the term of the individual contract that the contract will not settle net and will result in physical delivery of a security when it is issued. <p>If the above criteria are met, they are considered regular way trades.</p> <p>There is diversity in industry practice for TBAs and when-issued (“WI”); Merrill accounts for WIs/TBAs as derivatives and does not follow FAS 133.59(a); Goldman follows FAS 133.59(a) and identifies contracts that would fall under the regular-way trade exception; Morgan Stanley accounts for WI contracts as cash instruments with an understanding that some contracts may meet FAS133.59(a) conditions and others may not (MS treats TBAs as derivatives).</p> <p>Based on conversation with Product Control (M. McGarvey), the primary use of TBAs in the market place is for interest</p>	Accounting Policy Manual – Derivatives – non-regular-way and when-issued/pre-auction securities transactions	Current practice is correct	\$438,335 buys*	\$430,752 buys*	
				\$453,234 sells*	\$441,488 sells*	
				\$582 **	\$575 **	

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
----- TBAs – derivatives MTM netting	<p>rate risk hedging and Lehman desks (e.g., mortgage pass through) that generate significant trading volumes in TBAs are desks trading interest products or market makers that facilitate customer flows. A portion of their TBA trades may settle in physical delivery; such settlement option is primarily driven by customer demand and market conditions. We cannot demonstrate at trade inception that we may settle the trade net or in physical delivery. The only time we know about the settlement choice is 48 hours prior to settlement. Therefore, we believe our TBA trades do not meet all the criteria in FAS 133.59(a) and would not be considered regular-way trades (or cash instruments). Our current treatment of TBAs as derivatives is GAAP compliant.</p> <p>In Lehman systems, TBAs are recorded in notional values. Because we currently treat all TBAs as derivatives, a balance sheet adjustment is necessary to derecognize the notional values recorded for those TBAs. The amount (denoted *) represents the notional value adjustments.</p> <p>GAAP Reference: FAS 133, "Accounting for Derivative Instruments and Hedging Activities ("FAS 133")," paragraphs 10a and 59a, and the BD Guide, paragraph 7.21</p> <p>-----</p> <p>The amount (denoted **) represents the net-down of MTM receivables and payables of the TBA securities that are derivatives under the current practice.</p>					

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
	GAAP Reference: FIN 39, FAS 133 and the BD Guide, paragraph 7.21.					
Repurchase and reverse repurchase agreements netting under FIN 41	<p>Repurchase and reverse repurchase agreements that meet the conditions in paragraphs 3 and 4 of FIN 41 can be netted. This policy also covers certain buy/sell backs, and fixed income or equity repos and reverse repos documented under a standard market agreement such as a Global Master Repurchase Agreement (GMRA) or a Master Repurchase Agreement (MRA).</p> <p>Qualifying settlement systems permissible under FIN 41 and approved by Accounting Policy Group are: Federal Reserve System (FED), Fixed Income Clearing Corporation (FICC), Chase Triparty (in limited circumstances), Euroclear, Central Gilts Office (CGO), RepoClear, BOJ Net.</p>	<p>Accounting Policy Manual – Netting repurchase and reverse repurchase agreements</p> <p>Memo - Cross currency netting of repos and reverse repos</p>	Current practice is correct	\$202,329	\$168,333	<p>Accounting Policy Group is currently reviewing the netting proposal for Canadian reverse repo and repo trades using RBC as a settlement agent under FIN 41.</p> <p>Eurex Repo as a settlement system under review is put on hold by business in London.</p>

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
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	<p>We also have approved three clearing houses that are central counterparty clearing houses and that can be treated as counterparties: LCH.RepoClear, LCH.Clearnet SA (for French government and quasi-government trades) and LCH.Clearnet Italy (for Italian government and quasi-government trades).</p> <p>Non-qualifying securities transfer system is Depository Trust Company (DTC), because the Net Debit Cap DTC provides to participants is not considered the daylight overdraft or other intraday credit provided in an associated banking arrangement as contemplated in FIN 41.</p>	<p>within Euroclear under FIN 41</p> <p>Memo - Netting of repos and reverse repos within Clearnet under FIN 41</p>				
Repurchase and reverse repurchase agreements netting under FIN 41 (cont.)	GAAP Reference: FIN 39 and FASB Interpretation No. 41, "Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements" ("FIN 41")	Memo – Clearnet Italy – Netting of repos and reverse repos in Italian government debt securities executed on MTS Italy and cleared within LCH.Clearnet				

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
CUSIP netting	<p>Industry practice allows netting of long and short inventory positions with the same CUSIP number.</p> <p>Lehman follows the practice for consolidated financial reporting. In practice, netting is performed in GFS using “Synthetic Product ID” (which is the internal ID for securities and essentially equivalent to CUSIP). Long and short inventory positions of the same Synthetic Product ID are netted for the same legal entity (i.e., intra netting) as well as across legal entities (i.e., inter netting).</p> <p>GAAP Reference: None</p>	Accounting Policy Manual – Balance Sheet Netting	Current practice is correct	\$67,879 intra	\$57,954 intra	
Swaps on LCH SwapClear	<p>As a member of London Clearing House (“LCH”), a central counterparty clearing house, LBSF executes interest rate swaps on LCH SwapClear with other LCH members. We treat SwapClear as the central counterparty and hence our counterparty for the swap trades on SwapClear, and we net receivables and payables as a result of these trades.</p> <p>We understand LCH is a central counterparty exchange which novates trades executed on it. We are investigating if SwapClear trades can be netted under FIN 39 and if SwapClear can be viewed as a central counterparty and hence our counterparty for trades we enter into with other LCH members.</p> <p>GAAP Reference: FIN 39</p>	Accounting Policy Manual – Balance Sheet Netting	Current practice is under review	\$39 billion	\$37 billion	<p>We believe our current practice is correct because LBSF is a member of LCH and LCH novates trades of all its members.</p> <p>We surveyed some of our peers and the result of the survey is as follows: JPM said SwapClear was not on their FIN 39 netting list; Morgan Stanley permits multi-lateral netting of swaps on SwapClear and treats SwapClear as its counterparty; we inquired Merrill and are waiting to hear back from them.</p>

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Stock borrows vs. repo agreements via Chase tri-party	<p>We permit netting of stock borrows and repurchase agreements via Chase tri-party because we believe such trades meet the four conditions required in FIN 39.</p> <p>Stock borrows are executed under a Securities Lending Agreement (SLA) while repurchase agreements are executed under a Master Repurchase Agreement (MRA). A netting agreement with the counterparty provides netting provisions with respect to receivables from the stock borrows and payables from the repo trades. This netting agreement demonstrates LBI's right and intent to set off. Our internal counsel has reviewed the netting agreement and believes the netting provisions are legally enforceable. Through the Chase tri-party arrangement, we can demonstrate that we net settle the stock borrows and repo trades with the same counterparty.</p> <p>GAAP Reference: FIN 39 and the BD Guide, paragraphs 4.34 and 7.33</p>	<p>Accounting Policy Manual – Netting repurchase and reverse repurchase agreements</p> <p>Accounting Policy Manual – Netting stock loans and stock borrows</p> <p>Memo – FIN 41 Netting – Chase tri-party vs. Fed Wire (by K. Smith in 2001)</p> <p>Emails – LBIE FIN 41 – Adequacy of Chase daylight overdraft (K. Smith in 2004)</p>	Current practice is correct – see comments	\$28,828	\$30,372	The AICPA Accounting and Audit Guide on Depository and Lending Institutions section 14.30 says FIN 41 cannot be applied to securities borrowing and lending transactions. Paragraph 4.34 of the BD Guide states that “Securities borrowed and securities loaned transactions that do not have explicit settlement dates do not meet the requirement in paragraph 5c of FASB Interpretation No. 39.” This means stock borrows and stock lends with no explicit settlement dates cannot be netted under FIN 39. Therefore, we believe stock borrows and stock lends with explicit and coincident maturity dates may be netted under FIN 39.

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Bonds borrows vs. bonds loans via BOJ Netting under FIN 41	<p>Lehman policy permits bilateral netting of bond borrows and bond loans documented as GENTAN and settled via BoJNet under FIN 41. We do not permit multilateral netting because JGBCC is not a central clearing counterparty.</p> <p>BoJNet is a qualifying settlement system because it meets the conditions for a qualifying securities transfer system described in paragraphs 3 and 4 of FIN 41.</p> <p>An industry group including Goldman, Morgan Stanley and us has been trying to get the JGBCC rules changed so that JGBCC becomes a central clearing counterparty and novates all trades cleared. Among our peers, no-one but UBS nets JGBCC trades.</p> <p>GAAP Reference: FIN 41</p>	<p>Accounting Policy Manual – Netting repurchase and reverse repurchase agreements</p> <p>Memo - FIN 41 intra-day credit review</p> <p>Memo – Japanese legal advice: Gentan, Shin Gensaki and GMRA repurchase transactions</p>	Current practice is correct	\$14 billion	\$14.1 billion	At the SIFMA meeting on 3/27/07, the industry group decided not to reconvene for this purpose. Without changes to the JGBCC rules we will not be able to net on a novation basis.

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Derivative receivables and payables	<p>When derivatives are entered into with the same counterparty under a legally enforceable master netting agreement, the amounts recognized for those assets and liabilities may be offset, even if we do not have the intent to net settle (FIN 39, paragraph 10).</p> <p>Lehman policy permits multiple OTC contracts with a single counterparty under a global master netting agreement to be reported net on the balance sheet. Netting is applied within the same sub-ledger system as well as across different sub-ledger systems, if the OTC contracts reside in different sub-ledger systems.</p> <p>GAAP Reference: FIN 39</p>	Accounting Policy Manual – Balance Sheet Netting	Current practice is correct	\$11.6 billion	\$11.7 billion	See implementation list in Appendix A.
Cash collateral and derivatives	<p>Lehman policy permits netting of cash collateral received or paid against derivative receivables from or payables to the same counterparty provided that a master netting agreement provides legally enforceable netting rights and permits offset. Non-cash collateral is not eligible for netting.</p> <p>This policy also covers Contracts For Differences (CFD) transactions which are documented in the CFD Annex to the ISDA Master Agreements. Cash received or paid on CFD transactions results from the margin requirements that are documented in the margin clause of the CFD Annex. A netting legal opinion has been received from Allen & Overy and Ed Bardos of Lehman Legal has confirmed the external</p>	<p>Accounting Policy Manual – Balance Sheet Netting</p> <p>Accounting Policy email (6/5/2007) – netting approval on CFD transactions</p>	Current practice is correct	<p>\$10.3 billion longs</p> <p>\$6.4 billion shorts</p>	<p>\$11.1 billion longs</p> <p>\$8.2 billion shorts</p>	The amount of netting benefit does not include the benefit related to CFD transactions, which is estimated between \$300 million and \$500 million.

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
	<p>opinion can be relied on to support the netting conclusion.</p> <p>On 4/30/07, the Board issued a FSP FIN 39-1, "Amendment of FASB Interpretation No. 39." The FSP permits entities to offset cash collateral receivables or payables that approximate fair value with net derivative positions and is effective for fiscal years beginning after November 15, 2007, with early application permitted. We currently net cash collateral received and paid against derivative assets and liabilities, so the FSP confirms our current practice is correct.</p> <p>GAAP Reference: FIN 39, EITF Topic No. D-43, "Assurance That a Right of Setoff Is Enforceable in a Bankruptcy under FASB Interpretation No. 39," FSP FIN 39-1, "Amendment of FASB Interpretation No. 39."</p>					

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Listed equity options	<p>Lehman policy permits listed equity options that are traded on certain qualifying exchanges to be netted if the contracts are covered by a legally enforceable netting arrangement.</p> <p>Qualifying exchanges are Eurex (including SOFFEX, which merged with Eurex and ceased to exist) and London International Financial Futures Exchange (LIFFE).</p> <p>Options Clearing Corporation (OCC) is not a qualifying exchange for netting, but an industry effort to make OCC netting possible is underway.</p> <p>GAAP Reference: FIN 39</p>	<p>Accounting Policy Manual – Balance Sheet Netting</p> <p>Memo – Netting of listed options on Eurex in accordance with FIN 39</p> <p>Memo – Netting of listed options on LIFFE in accordance with FIN 39</p>	<p>Netting for Eurex and LIFFE is OK</p>	<p>\$4.3 billion on Eurex</p> <p>\$351 on LIFFE</p>	<p>\$4.2 billion on Eurex</p> <p>\$394 on LIFFE</p>	

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCS	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Receivables and payables on unsettled regular way trades	<p>AICPA Audit and Accounting Guide, "Brokers and Dealers In Securities" ("BD Guide") allows broker-dealers to report payables and receivables arising from unsettled regular-way transactions net on the balance sheet. This applies even if the counterparties are not the same. The exception exists because the special attributes (e.g., transactions are fully collateralized on trade date, settlement cycle is reasonably short, etc.) of regular-way unsettled trades of broker-dealers make the risk of nonperformance minimal.</p> <p>Lehman policy permits netting of trade date receivables and payables resulting from unsettled regular-way transactions and reporting of a single trade date receivable or payable amount on the balance sheet.</p> <p>GAAP Reference: AICPA Audit and Accounting Guide, "Brokers and Dealers in Securities," paragraphs 7.19 and 7.20 and FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts," ("FIN 39") paragraph 7</p>	Accounting Policy Manual – Balance Sheet Netting	Current practice is correct	\$2.1 billion	\$3.3 billion	

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Reverse repurchase vs. repurchase agreements via Chase tri-party	<p>We permit netting of reverse repurchase and repurchase agreements under FIN 41 because Chase tri-party (in limited circumstances) is an approved qualifying settlement system as it meets all the criteria of a qualifying securities transfer system described in paragraphs 3 and 4 of FIN 41.</p> <p>The legal entity using this structure is LBI.</p> <p>GAAP Reference: FIN 41</p>	<p>Accounting Policy Manual – Netting repurchase and reverse repurchase agreements</p> <p>Memo – FIN 41 Netting – Chase tri-party vs. Fed Wire (by K. Smith in 2001)</p> <p>Emails – LBIE FIN 41 – Adequacy of Chase daylight overdraft (K. Smith in 2004)</p>	Current practice is correct	\$1,123	\$3,265	

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Fails	<p>The BD Guide states that failed transactions (referred to as a fail-to-deliver or fail-to-receive) may be netted for financial statement reporting purposes to the extent the provisions of FIN 39 are met.</p> <p>We permit netting of failed transactions <u>only</u> if they have the same CUSIP and the same counterparty, regardless of our expectation or intent to settle net. This accounting treatment follows the regulatory reporting practice.</p> <p>The following are debits and credits on a sample repo trade that fails to settle (using fixed income securities as collateral): At the inception of the repo trade: Dr. Fail to deliver Cr. Repo Balance sheet is grossed up even though the repo trade fails to settle and hence no cash or securities are exchanged at the initiation of the trade.</p> <p>Assuming a repo trade settles at inception, however, on repurchase date, the same repo trade fails to settle: Dr. Repo Cr. Fail to receive No real balance sheet impact, except that repo payable is reclassified to fail to receive.</p> <p>GAAP Reference: FIN 39 and BD Guide paragraph 7.22</p>	Accounting Policy Manual – Balance Sheet Netting	Current practice is under review	\$481	\$329	<p>We record a balance sheet gross-up entry on fixed income repo and reverse repo trades that fail to settle. Failed repo and reverse repo trades on equities are not recorded; rather the whole financing contract is cancelled and hence has no financial impact on our balance sheet.</p> <p>Per Anuraj Bismal, 60% of the net-down amount is on financing transactions and 40% on inventory purchases and sales.</p>

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Taxes	<p>FAS 109, paragraph 42 allows current deferred tax liabilities (“DTL”) to offset current deferred tax assets (“DTA”) and non-current DTL to offset non-current DTA only within a particular tax jurisdiction and for a particular tax-paying legal entity.</p> <p>GAAP Reference: FAS 109, "Accounting for Income Taxes"</p>		Current practice is correct – see comments	\$370	\$378	We net all DTAs and DTLs across tax jurisdictions in consolidation and report a net DTA on the consolidated financial statements. In our footnote disclosure, we disclose DTAs and DTLs, respectively.

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
ADR CUSIP netting	<p>By analogy to CUSIP netting, Lehman policy currently permits the long (short) ADRs (American Depository Receipts) and the short (long) ordinary securities of the same issuer to be reported net on the balance sheet provided the following conditions are met:</p> <ul style="list-style-type: none"> - There are no liquidity restrictions on selling/transferring the ADRs; - There are no significant costs to convert the ADRs to their ordinary securities; - There are no market risk differences between the ADRs and the ordinary securities other than conversion costs, and - The ADRs must be convertible to ordinary securities within one settlement cycle. Therefore, the holder of the ADRs must be able to use the ADRs to make settlement of short ordinaries within one settlement period. <p>There is no specific accounting rule for ADR netting, but we believe ADRs represent substantially the same risk profile as the ordinary securities of the same issuer provided the above conditions are met.</p> <p>GAAP Reference: None</p>	Accounting Policy Manual – Balance Sheet Netting	Current practice is under review	\$348	\$468	<p>Most ADRs are sponsored by the companies creating them. There are three levels of sponsorship. A Level I sponsored ADR is created without needing to register with the SEC. So Level I ADRs can only be traded in the OTC Bulletin Board and have more liquidity risks. Level II and Level III sponsored ADRs must register with the SEC and Level III ADRs can be listed on the New York Stock Exchange or NASDAQ. Level III ADRs are by far the most liquid.</p> <p>We permit CUSIP netting only for Level III ADRs because of liquidity concerns about Level I and Level II ADRs.</p> <p>We do not net ETFs against their underlying securities. We surveyed our peers' practice with respect to ETF netting and we have found Morgan Stanley, Goldman and Citi</p>

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
						do not permit ETF netting. See implementation list in Appendix A.

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Dollar roll / dollar roll match customer netting	<p>Dollar rolls are agreements to sell and repurchase similar but not identical securities. They typically involve mortgage-backed securities. They differ from regular repurchase agreements in that the securities sold and repurchased, which are usually of the same issuer, are represented by different certificates, collateralized by different but similar mortgage pools, and generally have different principal amounts. For dollar rolls to be accounted for as financing transactions, conditions set forth in FAS 140 paragraphs 47(a) and 48 must be met. The key is that the assets to be repurchased or redeemed must be the same or substantially the same as those transferred.</p> <p>At Lehman, these dollar rolls are equivalent to buy/sell backs. Lehman records dollar rolls as reverse repo and repo transactions subject to FIN 41 netting with the same counterparty because the assets to be repurchased or redeemed are the same or substantially the same as those transferred.</p> <p>GAAP Reference: FAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," paragraphs 9(c)(1), 47(a) and 48, Q&A 140 #43 and #44, and FIN 41</p>	Accounting Policy Manual – Netting repurchase and reverse repurchase agreements	Current practice is correct	\$328	\$896	

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
"TRAINS" (Targeted return index securities trust)	<p>Lehman policy permits netting of the TRAINS certificates and their short hedges of the underlying securities (by analogy to CUSIP netting), only if the TRAINS trust does not allow lending of the underlying securities for a fee.</p> <p>Lending could cause disparity for TRAINS trusts on redemption. When the trust allows lending of the underlying securities for a fee to enhance the performance of the TRAINS trust, investors, who come to redeem the TRAINS, may only receive cash and not the underlying securities because the underlying securities may have been lent out by the trust and hence not available for redemption.</p> <p>GAAP Reference: None</p>	Memo - CUSIP netting for exchange traded funds and targeted return index securities	Limited (only if TRAINS trusts do not allow lending)	\$78	\$79	<p>APG reviewed the offering documents of a TRAINS trust, which indicates lending of the underlying bonds from the trust is permissible for a fee. Product Control (Clive Turner) confirms that Operations nets TRAINS against their short hedges of the underlying bonds on a daily basis. This practice is not consistent with Lehman policy.</p> <p>See implementation list in Appendix A.</p>

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Prime broker receivable and payable netting	<p>As a prime broker, we provide margin loans or securities loans to clients to facilitate their long purchase or short sale transactions. Clients also deposit cash with us to meet their margin requirements on the transactions.</p> <p>When we provide loans of cash and securities and receive margin deposits, we record receivables and payables on our own balance sheet and we net any receivables and payables with the same hedge fund clients.</p> <p>The Prime Brokerage Agreement (PB Agreement) Clause 6 on Payment and Delivery indicates that we can apply any of the cash or securities paid or delivered by the clients to satisfy any amounts owed to us by the clients in the normal course of the business. In practice, client accounts are set up so that margin debits and credits are netted for the same client to reflect the net exposure with that client. In addition, the PB Agreement's close-out clause also provides a net settlement in the even of default. Given these clauses, we believe we have the appropriate right of setoff as required by FIN 39. Provided the right of setoff as documented in the PB Agreement is enforceable at law, the current practice of reporting net receivables or payables with the same hedge fund client complies with FIN 39.</p> <p>GAAP Reference: FIN 39</p>	N/A	Current practice is correct – see comments	***	***	<p>We need to get internal counsel opinion on the enforceability of the right of setoff as documented in the PB Agreement.</p> <p>If Legal confirms, there is no need to discuss this with E&Y.</p> <p>We have also found that Goldman reports net receivables or payables for the prime brokerage client margin activities.</p> <p>*** Due to system limitations, the new-down amounts for prime brokerage accounts are not available, as per Chris Li.</p>

II. Balance Sheet Netting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Repurchase and reverse repurchase agreements netting under Chase settlement structure	<p>The structure involves repo and reverse repo trades using securities that are DTC or Fedwire eligible. Via the Chase settlement structure, Chase is the settlement agent responsible for settling the securities and cash as a result of the repo and reverse repo trades between LBI and our hedge fund clients.</p> <p>The Chase settlement structure meets all the conditions for a qualifying securities transfer system described in paragraphs 3 and 4 of FIN 41. Provided the trades meet other conditions of FIN 41, we permit netting of these repo and reverse repo trades with hedge fund clients on an individual counterparty basis.</p> <p>GAAP Reference: FIN 41</p>	Memo – LBI balance sheet netting using FIN 41 – DTC eligible reverse repurchase agreements vs. Fedwire eligible repurchase agreements via Chase agent DTC Box on behalf of LBI	Current practice is correct – see comments	minimal	nil	<p>E&Y approved the proposal of the Chase settlement structure on February 2, 2007. We had minimal amount of net-down as of 2/28/07.</p> <p>John Feraca confirmed that, at the end of April, we had approximately \$2 billion of trades that we would net. We plan to grow this amount to approximately \$6 - \$7 billion by mid-summer for balance sheet net-down.</p>

III. Exceptions to Trade Date Accounting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Whole loan purchase commitments	<p>Lehman’s commercial real estate and residential mortgage businesses may, from time to time, make rate lock commitments or enter into forward purchase contracts to purchase loans from counterparty mortgage banks, which are required to originate mortgage loans at the option of borrowers.</p> <p>DIG C13 applies to both residential and commercial loan commitments and requires them to be accounted for as derivatives and recorded at fair value. Loan commitments to extend credit to commercial or industrial entities that will not give rise to mortgage loans are not addressed by DIG C13. However, under the BD Guide, we record all loan commitments to third parties at fair value.</p> <p>Because Lehman’s accounting systems recognize the notional amounts of the loan commitments when they are made, a balance sheet adjustment (i.e., Dr. trade date accrual and Cr. inventory) is necessary to derecognize the notional amounts booked so that we correctly record loan commitments as derivatives.</p> <p>GAAP Reference: FAS 133</p>	Accounting Policy Manual – Loan commitments	Current practice is correct	\$12,425 buys	\$12,961 buys	

III. Exceptions to Trade Date Accounting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Specified mortgage pools (GAWA trades) and Hoffman trades	<p>GAWA trades are delayed-delivery trades for specified mortgage pools in which both parties to the trade agree on a specified settlement date. They are purchases or sales of existing securities similar in most respects to regular way transactions (normal settlement) except that, by agreement, the date of consummation or settlement is specified. GAWA trades are typically OTC contracts negotiated between two parties and settlement periods for these contracts vary from one contract to another.</p> <p>The BD Guide requires delayed-delivery trades to be treated as derivatives between trade date and settlement date. Therefore, Lehman policy requires the GAWA trades to be accounted for as derivatives.</p> <p>Hoffman trades are primarily forward sales of US treasuries with a settlement period as long as 120 days. The contracts permit net settlement. Therefore, Hoffman trades are derivatives.</p> <p>Because Lehman's accounting systems recognize the notional amounts of the trades, a balance sheet adjustment (i.e., Dr. trade date accrual and Cr. Inventory) is necessary to derecognize the notional amounts recorded in the accounting systems prior to settlement date.</p>	<p>Accounting Policy Manual – Derivatives – non-regular-way and when-issued/pre-auction securities transactions</p> <p>Memo - Accounting policy - other netting considerations (by K. Smith in 2004)</p>	Current practice is correct	\$6,226 GAWA*	\$567 GAWA*	* This includes GAWA and other ledgers with similar trades as GAWA ledger (e.g., GMJ9).
				\$1,799 Hoffman	\$1,548 Hoffman	

III. Exceptions to Trade Date Accounting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
	GAAP Reference: FAS 133, E&Y FAS 133 Guide 2.15, and BD Guide, paragraphs 1.63, 2.103 and L.17					

III. Exceptions to Trade Date Accounting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCs	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Forward purchase or sale of when-issued/pre-auction securities	<p>When issued (“WI”) transactions are contracts to purchase or sell securities only when, as, and if new securities are issued. Because the exact price and terms of the securities are unknown before the issuance date, trading prior to that date is based on the yield buyers expect to be issued of the security.</p> <p>In accordance with FAS 133.59(a), forward purchases or sales of when-issued or pre-auctioned securities <u>that do not yet exist</u> are generally treated as derivative contracts, unless they meet the following criteria:</p> <ul style="list-style-type: none"> - There is no other way to purchase or sell that security; - Delivery of that security and settlement will occur within the shortest period possible for that type of security. - It is probable at inception and throughout the term of the individual contract that the contract will not settle net and will result in physical delivery of a security when it is issued. <p>If the above criteria are met, trades are considered regular way trades.</p> <p>There is diversity in industry practice for WI transactions: Merrill accounts for WIs as derivatives and does not follow FAS 133.59(a); Goldman follows FAS 133.59(a) and identifies contracts that would fall under the regular-way trade exception; Morgan Stanley accounts for WI contracts as cash instruments with an understanding that some contracts may</p>	<p>Accounting Policy Manual – Derivatives – non-regular-way and when-issued/pre-auction securities transactions</p> <p>Memo - Accounting policy - other netting considerations (by K. Smith in 2004)</p>	<p>Current practice is under review – see comments</p>	<p>\$5,458 buys</p> <p>\$1,166 sells</p>	<p>\$911 buys</p> <p>\$2,880 sells</p>	<p>We historically have accounted for our forward purchases and sales of WIs as derivatives because we think the BD Guide, in the sections that discuss when-issued or TBAs (e.g., sections 2.103 and 7.21), would require these contracts to be accounted for as derivatives and industry practice supports this view.</p>

III. Exceptions to Trade Date Accounting

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOCS	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
	<p>meet FAS 133.59(a) conditions and others may not (MS treats TBAs as derivatives). Based on conversation with our business and operations people, we believe the majority of our WIs would meet the three criteria in FAS 133.59(a) and would be considered regular-way trades (or cash instruments) and not derivatives.</p> <p>The amounts represent adjustments to derecognize the purchase or sale values of when issued/pre-auction securities recorded in the system prior to settlement date, because they are accounted for as derivatives and only the MTM is recognized until settlement.</p> <p>The adjusting entries are as follows: For purchases: Dr. trade date accrual and Cr. Inventory For sales: Dr. inventory and Cr. Trade date accrual</p> <p>GAAP Reference: FAS 133, BD Guide, paragraphs 2.103 and 7.21, and Statement 133 Implementation Issue No. C 18, "Shortest Period Criterion for Applying the Regular-Way Security Trades Exception to When-Issued Securities or Other Securities That Do Not Yet Exist"</p>					

IV. Other Balance Sheet Adjustments

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOC's	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Repo 105 and Repo 108	Under certain conditions that meet the criteria as described in paragraphs 9 and 218 of FAS 140, Lehman policy permits reverse repo and repo agreements to be recharacterized as purchases and sales of inventory. GAAP Reference: FAS 140	Accounting Policy Manual – Repo 105 and Repo 108	Current practice is correct	\$29,258	\$24,519	
Reverse repo/stock loan participation and warehouse reverse repo participation	At month-end, reverse repo and securities loan contracts with risks for only one remaining night are sold to participation buyers along with the collateral. Buyers get the economics for one day and on the next day these contracts mature. Lehman continues to service these contracts subsequent to the transfers. Lehman Brothers Bank establishes a single borrower limit and from time to time needs to participate out the warehouse line in order to meet the single borrow limit. Lehman policy permits the participation contracts to be accounted for as sales contracts, provided FAS 140 paragraph 9 conditions are satisfied. GAAP Reference: FAS 140	Accounting Policy Manual – Securitizations – criteria for de-recognition Accounting Policy Manual – Repurchase agreement participations	Current practice is correct	\$16,426 reverse repo/stock loan \$805 warehouse	\$7,255 Reverse repo/stock loan) \$704 warehouse	Reverse-Repo Participation Agreement legal opinion dated 4/14/2005 by Hahn & Hessen and Securities Loan Participation Agreement dated 12/05/2005 by Hahn & Hessen are on file.

IV. Other Balance Sheet Adjustments

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOC's	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Repo/ reverse repo to maturity	Repurchases to maturity can be recognized as sales provided the criteria in paragraph 9 of FAS 140 are met. Because control is surrendered for the entire remaining life of the security, the obligation to repurchase the asset is not considered to provide the transferor with effective control under paragraph 9(c). Upon receipt of the security at maturity, the instrument has matured or expired. To meet criterion 9(a), a legal opinion on true isolation of transferred assets from the transferor must be obtained. GAAP Reference: FAS 140, paragraphs 9(C)(1), 47-49, 98, and 213; FAS 140 Q&A Q48	Accounting Policy Manual – Repo to maturity	Current practice is correct	\$4,574 on reverse repo	\$4,608 on reverse repo	See implementation list in Appendix A.
Repo Reinvest program	"Repo Reinvest" is a program in which a customer lends securities (equity or fixed income) to Lehman and Lehman pledges other securities (equity or fixed income) to collateralize its borrows. Lehman pays a fee to the counterparties. The transaction involves a borrow leg and a repo leg and they are both settled through Chase tri-party. In the borrow leg, Lehman borrows securities free from the counterparties via Chase tri-party (i.e., Chase posts intra-day cash collateral to the counterparty on behalf of Lehman). In the repo leg, Chase delivers securities to the counterparty on behalf of Lehman and the counterparty posts cash collateral via the Chase tri-party account, so cash is credited back to Lehman (making Lehman's cash account flat). Securities via	Accounting Policy Manual – Netting stock loans and stock borrows Memo – Repo Reinvest program Email - BGI	Current practice is under review – see comments	\$2,873	\$3,453	In the past, we considered Repo Reinvest transactions to be identical to "borrow versus pledge" securities lending transactions, in which Lehman is the borrower of securities and paying a fee and the counterparty is the lender of other securities. FAS 140 requires a gross-up for the lender of securities to recognize the receipt of the non-cash collateral and the liability to

IV. Other Balance Sheet Adjustments

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOC's	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
	<p>repo are therefore pledged to the counterparty to collateralize the borrows. Through the Chase tri-party arrangement, Lehman does not need cash available to settle either leg.</p> <p>Active Program participants include Bank One Columbus Corp Triparty, Bank One Columbus Tri Party Repo, Dwight Asset Mgmt Co Inc A/C F&G, Dwight Asset Mgmt Co Inc A/C TAR, Frost National BK Sec Lending PR, Citigroup Travelers and BGI using equities as collateral.</p> <p>We believe we can net the stock borrows and the repo agreements for balance sheet reporting in accordance with FIN 39, provided we can demonstrate the right of setoff and the settlement execution pattern via Chase tri-party arrangement.</p> <p>Because Lehman systems record the transactions of both legs (i.e., debits in stock borrows and credits in repos), we make the adjustment (i.e., Dr. repos and Cr. stock borrows) to reverse the recorded transactions from the balance sheet.</p> <p>GAAP Reference: FIN 39</p>	equity vs. equity program trade				<p>return the collateral, but does not require the same gross-up for the borrower of securities. Therefore, our policy has permitted Repo Reinvest transactions not to be recognized on the balance sheet.</p> <p>This view was documented in a memo dated 3/17/1994.</p> <p>The last time a Repo Reinvest transaction was reviewed and approved internally was 11/01/2005 on a BGI equity vs. equity program trade.</p>

IV. Other Balance Sheet Adjustments

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	INTERNAL POLICY & DOC's	NETTING DECISION	VALUE (in millions)		COMMENTS
				2/28/07	11/30/06	
Lehman issued debt	<p>FAS 140 paragraph 16 requires extinguishment accounting for the acquisition of own debt. Lehman policy calls for accounting for own debt in inventory at month end as extinguished and to derecognize the own debt in inventory and the related debt obligation from the balance sheet.</p> <p>GAAP Reference: FAS 140, paragraph 16</p>	Accounting Policy Manual – Own debt in inventory	Current practice is correct	\$1,634	\$1,161	
Total return swaps (Ping Feng TRS)	<p>Lehman transfers assets to a counterparty (BGI) subject simultaneously to a total return swap contract with the same counterparty to swap back the economics of the assets transferred. The adjustment amount represents the market value of the assets derecognized from the balance sheet, because the trader books a repo to represent the financing of the swap contract in the trading system.</p> <p>We allow sales accounting for these swaps as a one off exception. It is unlikely we can obtain legal opinion under US law that says a transfer with a TRS is a legal true sale. Thus, no other exceptions have been granted.</p> <p>GAAP Reference: FAS 140</p>	<p>Memo – Accounting policy - other netting consideration (by K. Smith in 2004)</p> <p>Memo – Lehman Brothers off-balance-sheet transactions (by K. Smith in 2002)</p>	Practice is correct but only for Ping Feng TRS	\$412	\$469	

V. Appendix A – Implementation List

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	NETTING DECISION	TO DO	OWNER
ADR CUSIP Netting	<p>By analogy to CUSIP netting, Lehman policy currently permits the long ADRs and the short ordinary securities of the same issuer (and vice versa) to be reported net on the balance sheet provided the following conditions are met:</p> <ul style="list-style-type: none"> - There are no liquidity restrictions on selling/transferring the ADRs; - There are no significant cost to convert the ADRs to their ordinary securities; - There are no market risk differences between ADRs and the ordinary securities other than conversion cost, and - The ADRs must be convertible to ordinary securities within one settlement cycle. Therefore, the holder of the ADRs must be able to use the ADRs to make settlement of short ordinaries within one settlement period. <p>There is no specific accounting rule for ADR netting, but we feel that ADRs should be considered to represent substantially the same risk profile as the ordinary securities of the same issuer provided the above conditions are met, and hence we permit ADR netting by analogy to CUSIP netting.</p> <p>GAAP Reference: None</p>	Current practice under review	<ol style="list-style-type: none"> 1. London Financial Control is to review the netting conditions as described in this policy and let us know if they have issues implementing the policy. 2. NY Balance Sheet Group is looking to see if there is ADR netting for legal entities other than IBIE. 	<p>Terry Burke</p> <p>Anuraj Bismal</p>
Derivative receivables and payables	When derivatives are entered into with the same counterparty under a master netting agreement, the amounts recognized for those assets and liabilities may be offset, even if we do not have the intent to net settle. (FIN 39, paragraph 10)	Current practice is correct	A netting enforceability project is underway to build a firm wide database for enforceability rules and for ongoing evaluation. There is a potential less netting as a result of this project, because	Eric Spray, Anna Yu, Kristine Smith, Anuraj Bismal etc.

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	NETTING DECISION	TO DO	OWNER
	<p>When derivatives are entered into subject to a master netting agreement, they do not automatically qualify for netting. The legal enforceability of the contract must be evaluated.</p> <p>Lehman policy permits multiple OTC contracts with a single counterparty under a global master netting agreement to be reported net on the balance sheet. Netting is applied within the same sub-ledger system as well as across different sub-ledger systems.</p> <p>GAAP Reference: FIN 39</p>		<p>most of our ISDA agreements are OK, but agreements with foreign entities such as China may have enforceability issues.</p> <p>Parties involved are TMG, Market and Credit Risk, Regulatory Reporting, Risk Technology, External Reporting, Balance Sheet Group and GFS representatives.</p>	
<p>"TRAINS" (Targeted return index securities trust)</p>	<p>Lehman policy permits netting of the TRAINS certificates and their short hedges of the underlying securities (by analogy to CUSIP netting), only if the TRAINS trust does not allow lending of the underlying securities for a fee.</p> <p>Lending could cause disparity for TRAINS trusts on redemption. When the trust allows lending of the underlying securities for a fee to enhance the performance of the TRAINS trust, investors, who come to redeem the TRAINS, may only receive cash and not the underlying securities because the underlying securities may have been lent out by the trust and hence not available for redemption.</p> <p>Accounting Policy Group reviewed the offering documents of a TRAINS trust, which indicates lending of the underlying bonds from the trust is permissible for a fee. Product Control confirms that Operations nets TRAINS against their short</p>	<p>Limited</p>	<p>Product Control must review the TRAINS funds' legal documents to ensure netting applies to those that do not allow lending of the underlying securities.</p>	<p>Clive Turner</p>

SUBJECT	TRADE DESCRIPTION & US GAAP REFERENCE	NETTING DECISION	TO DO	OWNER
	hedges of the underlying bonds on a daily basis. This practice is not consistent with Lehman policy.			
Repo/ reverse repo to maturity	Repurchases to maturity can be recognized as sales provided the criteria in paragraph 9 of FAS 140 are met. Because control is surrendered for the entire remaining life of the security, the obligation to repurchase the asset is not considered to provide the transferor with effective control under paragraph 9(c). Upon receipt of the security at maturity, the instrument has matured or expired. To meet criterion 9(a), a legal opinion on true isolation of transferred assets from the transferor must be obtained. GAAP Reference: FAS 140, paragraphs 9(C)(1), 47-49, 98, and 213; FAS 140 Q&A Q48	Current practice is correct	We will give the policy to FO or PC for implementation. This would include a legal opinion.	John Feraca