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Sent: Tuesday, September 2, 2008 5:23 PM (GMT)
To: Shotton, Paul <paul.shotton@lehman.com>
Cc: Weber, Mark <mark.weber@lehman.com>
Subject: Stress Testing Update
Attach: Stress Results- IT viewv3.xls

Hi Paul

Please find attached a spreadsheet with updated stress results as of June. (The rows shaded red need sign-offs from you/Jeff/are not finalized yet)

For documentation purposes, I wanted to jot down the changes that are being made to Stress testing.

The following changes have been made to the Credit Crunch scenario:
Overall changes:

1. The results have been divided into two categories: Liquid Positions and Illiquid Positions. Liquid Positions would typically include positions that can be liquidated within a quarter. Rest of the positions would fall under Illiquid Positions (it would typically include firm's Real Estate and Private Equity positions).
2. Illiquid Positions have been divided into two categories: "Through the cycle" and "Over a quarter". "Through the cycle" stress P&Ls would reflect P&Ls resulting from severe spread movements in various market indicators (the level of severity is expected to depend on the stage in the business cycle we are in at that point in time). "Over a quarter" stress P&Ls would reflect P&Ls resulting from spread movements in various market indicators over a quarter.

Liquid Positions:

The following changes have been made to shock sizes in the Credit Crunch scenario under Liquid Positions:

1. Securitized Products: The mortgage shocks have been modified to include market movements in the past year and a half. The shocks use worst peak to trough moves over a period of roughly two months.
2. Real Estate: All of Real Estate positions for Credit Crunch have been shifted to Illiquid Positions.
3. Principal Investing Portfolio (PIP): DPI and GOG have been added as separate businesses under PIP. These were not being stressed at all earlier.

Illiquid Positions:

Real Estate and Private Equity positions were previously not being stressed appropriately under Stress Testing. So, the Illiquid Positions section has been introduced to account for the same. The following shocks have been proposed as the first cut:

1. Private Equity: Shock sizes are- (a) 30% decline in Market Value for "Through the cycle" and (b) 10% decline in Market Value for "Over a

quarter"

2. Real Estate: The shocks are based partially on the recession of early 90s. Property value based shocks have been applied based on property type. Spread shocks have been used wherever property value based shocks don't capture the risk.

Caveats and open items:

1. CMBS shocks under Securitized Products in Liquid Positions are based on spread movements in 2007-08. Similar positions in Real Estate under Illiquid Positions have been stressed using market movements in early 90s. Further analysis is needed to restore consistency.
2. Whereas Real Estate is generating stress losses under other scenarios under Liquid Position. The loss for Real Estate under Liquid Positions for Credit Crunch is zero. This is because all of Real Estate for Credit Crunch has been included under Illiquid Positions.
3. Even though an attempt has been made to include all of firm's positions under Stress testing, some of the positions are still not included: For e.g., some of the banking book positions under Securitized Products like mortgage warehouse deals etc. More work is needed for deciding a stress methodology for such positions.
4. Real Estate positions under IMD need to be included. This is expected to be completed in the next day or so.
5. Signoffs are needed from Jeff Goodman for the new Securitized Products Americas shocks and signoffs are needed from Don Petrow for Real Estate Europe and Asia stress numbers.

I will keep updating the sheet and the documentation above.

Regards
Nancy

<<Stress Results- IT viewv3.xls>>
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