

2006 Bondholder Meeting Risk Management

Madelyn Antoncic
Chief Risk Officer

October 17, 2006

LEHMAN BROTHERS

Cautionary Notes

Some of the statements contained in this presentation, including those relating to Lehman Brothers' strategy and other statements that are predictive in nature, that depend on or refer to future events or conditions or that include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions, are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These statements are not historical facts but instead represent only Lehman Brothers' expectations, estimates and projections regarding future events. These statements are not guarantees of future performance and involve uncertainties that are difficult to predict, which may include, but are not limited to, market fluctuations and volatility, industry competition and changes in the competitive environment, investor sentiment, liquidity risks, credit ratings changes, credit exposure, legal and regulatory proceedings and changes. For further discussion of these risks, see "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Lehman Brothers' most recent Annual Report on Form 10-K and Quarterly Report on Form 10-Q. As a global investment bank, the Firm's results of operations have varied significantly in response to global economic and market trends and geopolitical events. The nature of the Firm's business makes predicting the future trends of revenues difficult. Caution should be used when extrapolating historical results to future periods. The Firm's actual results and financial condition may differ, perhaps materially, from the anticipated results and financial condition in any such forward-looking statements and, accordingly, readers are cautioned not to place undue reliance on such statements. Lehman Brothers undertakes no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. Lehman Brothers' U.S. brokerage business is conducted through its wholly-owned subsidiary, Lehman Brothers Inc.

Certain information contained in this presentation has been obtained from third party sources that Lehman Brothers believes to be reliable; however, Lehman Brothers assumes no responsibility for the accuracy of the information.

Copies of documents filed with the SEC by Lehman Brothers can be obtained at the SEC's Internet site (www.sec.gov) and from Lehman Brothers, Investor Relations, 745 Seventh Avenue, New York, New York 10019 (212-526-3267). In addition, Lehman Brothers makes available on its Internet site (www.lehman.com) its most recent Annual Report on Form 10-K, its Quarterly Reports on Form 10-Q for the current fiscal year, its most recent proxy statement and its most recent annual report to stockholders, although in some cases these documents are not available on that site as soon as they are available on the SEC's site.

Table of Contents

I. Risk Governance

- Risk Philosophy
- Committee Structures

II. Risk Management

- Risk Management Function
- Risk Management Organization
- External Constituents

III. Risk Analysis and Quantification

- Risk Management Integrated Framework
 - Risk Appetite
 - Risk Equity
 - Risk Appetite Usage
 - Stress Tests

IV. Conclusion

Risk Governance

LEHMAN BROTHERS

Our Control Environment

- ◆ Risk Management is one of our core competencies
 - ◆ It is Multi-Tiered and involves many areas of the Firm
 - ◆ One key feature which differentiates us from our peers is Market risk and Credit risk are integrated
 - Allows us to leverage people, analytics, systems, information flows
 - ◆ Risk Management is more than measuring and reporting risk
 - ◆ Our approach applies analytical rigor overlaid with sound practical judgment
 - ◆ Risk Management is a partnership with the business
 - We work proactively with the business before a large trade is done to collectively determine the least risky deal structure
 - ◆ Risk Management
 - Develops risk policies and procedures
 - Develops risk measurement methodologies
 - Sets limits
 - Tracks actual risk usage against limits
 - Evaluates valuation models
-

Risk Philosophy

- ◆ Our focus is balancing risk vs. return
 - We want to help insure Lehman Brothers' risk appetite is deployed in the most efficient way
- ◆ At the end of the day `nothing is fool-proof. While there is no guarantee against loss, we can minimize the probability of loss
 - We minimize market and credit risk through our client-driven franchise where we facilitate customers
 - We proactively manage risk both before and after trades are done by mitigating risk via management of the terms, outright sales or syndication, or hedging the remaining risk
 - We actively manage collateral assessment and collection where applicable
 - Risk is minimized through geographic, industry, asset class and customer diversification

Committee Structures

- ◆ Lehman Brothers has established numerous committees to oversee risk taking activities and to ensure that controls are appropriately administered and reviewed
 - ◆ The key operating committees at the Firm include
 1. Executive Committee
 2. Management Committee
 3. Operating Exposures Committee
 4. Finance Committee
 5. Capital Markets Committee
 6. Risk Committee
 7. Commitment Committee
 8. Bridge Loan Committee
 9. Investment Committee
 10. Fairness Opinion Committee
 11. New Products Committee
 12. Complex Structured Finance Transaction Committee
 13. Strategic Acquisition Review Committee
 14. High Grade Credit Committee
 15. High Yield Credit Committee
 16. Loan Participation Committee
 17. Structured Finance Committee
 18. Equity Commitment Committee
 19. IMD Product Review Committee
 20. Executive Oversight Committee
- Management Oversight Committees**
- Firmwide Transaction Approval Committees**
- Business Level Transaction Approval Committees**

Risk Management

LEHMAN BROTHERS

Risk Management Function

Risk Management is Independent from Trading

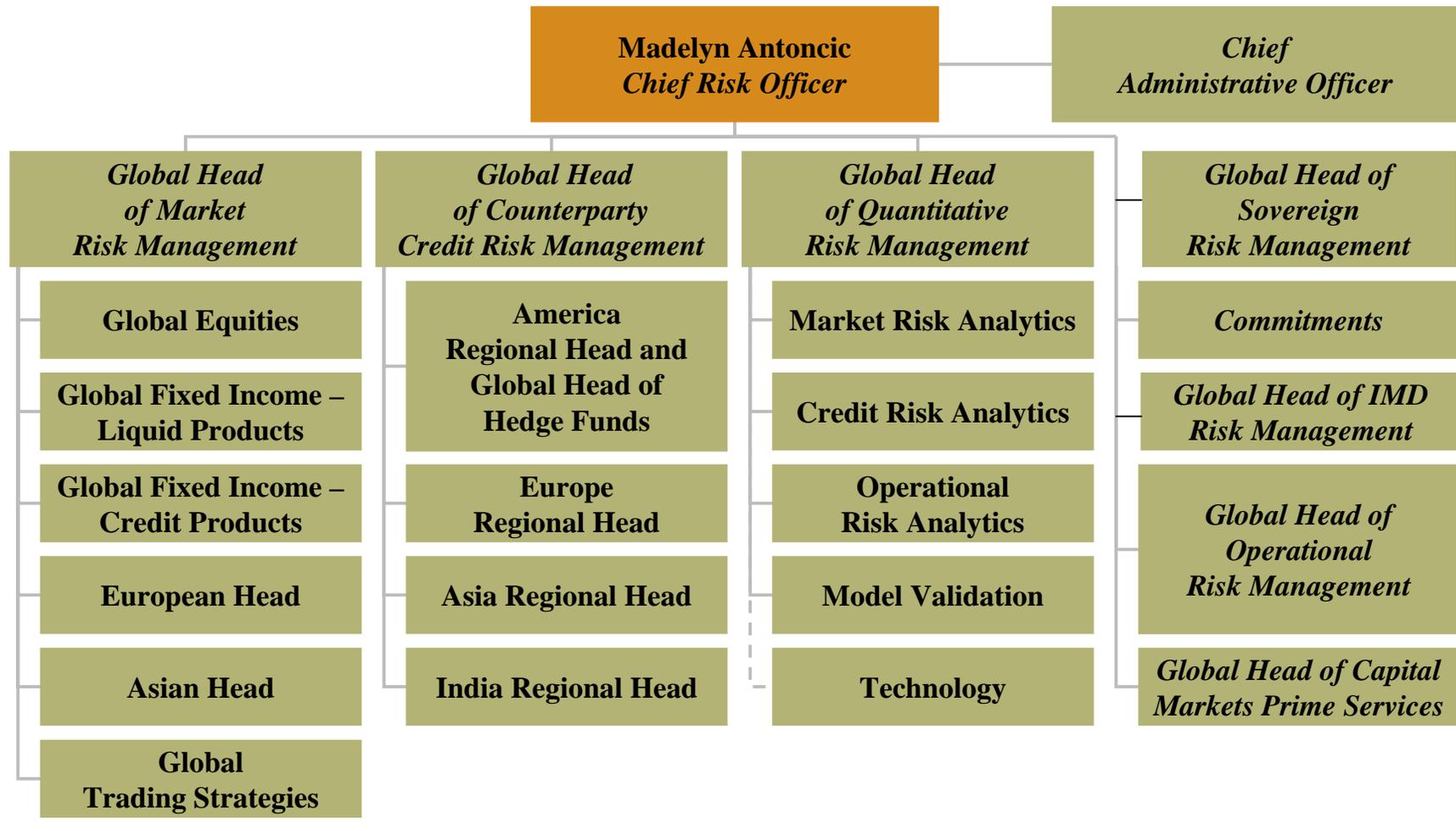
- ◆ The Global Risk Management Division is independent of the trading areas
- ◆ The Chief Risk Officer, Madelyn Antoncic, is a member of the Management Committee and reports directly to the Firm's Chief Administrative Officer (Dave Goldfarb), a member of the Executive Committee, who reports to the Chairman and CEO (Dick Fuld) and ultimately to the Board of Directors of the Firm
- ◆ The Firm's Chief Risk Officer also meets with the Board of Directors and the Finance Committee of the Board of Directors to review risk utilization and other topical risk issues
- ◆ The Global Risk Management Division consists of several departments
 - Market Risk Management
 - Credit Risk Management
 - Quantitative Risk Management
 - Operational Risk Management
 - Sovereign Risk Management
 - Investment Management Division Risk Management
- ◆ Outside the U.S., Risk Management is “matrixed” reporting both to global risk management managers and regional heads consistent with the trading businesses organization structure

Risk Management Function

- ◆ Market Risk Management is responsible for ensuring all market risks are identified, understood, measured, monitored and captured by an appropriate metric. Risk managers work very closely with the trading desks in assessing risk and sit on trading floors with the desks they support
- ◆ Credit Risk Management is responsible for counterparty credit analysis and due diligence; assigning and maintaining internal risk ratings; credit limits for each counterparty; establishing country risk limits; preparing credit reviews; monitoring Counterparty Credit Exposures on a current (CCE) and potential basis (MPE) including usage of credit limits
- ◆ Quantitative Risk Management is responsible for developing, implementing and maintaining the risk methodologies and systems used to measure market, credit and operational risks, as well as validating the pricing and valuation models used by the business units of the Firm
- ◆ Sovereign Risk Management is responsible for establishing a framework to assess political, economic, and social conditions and events in a foreign country that might adversely affect the Firm's interests or reputation
- ◆ Operational Risk Management is responsible for ensuring all operational risks are identified, understood, measured and monitored

Risk Management Organization

- ◆ Risk Management is a global, integrated function under the leadership of the Chief Risk Officer, Madelyn Antoncic. The Global Risk Management Department consists of 310 professionals, with 201 risk managers and 109 technologists



Risk Management Organization

Risk Management Qualifications

- ◆ The Global Risk Management Division (“GRMD”) consists of 310 professionals with staff in each of the Firm’s three trading centers, as well as credit risk personnel in key sales regional offices
 - Chief Risk Officer
 - Chief Administrative Officer and Staff
 - 56 Market Risk
 - 67 Credit Risk (Counterparty Credit and Commitments)
 - 30 Quantitative Analysis / Model Validation
 - 18 Quantitative Reporting
 - 8 Operational Risk
 - 5 Sovereign Risk
 - 5 IMD Risk
 - 9 Admin
 - 109 Technology
- ◆ Excluding technologists and administrative staff, we have 192 professionals in GRMD. These professionals are highly qualified, with advanced degrees and substantial experience. Many are either former traders, former desk quants or have relevant business experience

	Global (CRO / CAO)	Market Risk	Credit Risk	Quantitative Analysis	Quantitative Reporting	Sovereign Risk	IMD Risk	Total
PhD	33%	26%	0%	66%	0%	20%	0%	20%
Masters	0%	59%	34%	30%	17%	80%	100%	41%
Bachelors	34%	15%	64%	4%	77%	0%	0%	37%
Other	33%	0%	2%	0%	6%	0%	0%	2%
Total	100%	100%	100%	100%	100%	100%	100%	100%
Percentage of Former Traders, Desk Quants and Business	33%	31%	19%	19%	N/A	40%	25%	22%

External Constituents

Relationship with Regulators

- ◆ The Firm enjoys an excellent relationship with its regulators
- ◆ Many senior members of the Firm's Compliance group have either worked at, or with those who work at, the regulatory agencies. Members of the GRMD and the Compliance department also participate in numerous industry associations and sub-committees together with representatives from the regulatory agencies. This has allowed the Firm to develop a good working relationship with the various regulatory bodies
- ◆ Representatives of Finance and Risk meet monthly with the SEC (division of Market Regulation) to discuss the Firm's risk metrics and financial performance. This began as a voluntary meeting agreed to in order to help the SEC develop a better understanding of the Firm and is now part of the CSE process
- ◆ The Firm was approved by the SEC as a Consolidated Supervised Entity (CSE) effective November 2005. This designation permits the Firm and its ultimate holding company to calculate net capital using certain risk based standards for market and credit risk
- ◆ In addition, the NYSE, the CBOT, the OTS (for Lehman Brothers Bank) and the FSA in Europe and Asia and the BaFin in Germany conduct annual examinations and there have been no significant findings

External Constituents

Relationship with Rating Agencies

- ◆ Risk Management is one of the key groups facing off with the rating agencies and has built excellent relationships with them. The agencies consistently cite our strong risk management function and framework as one reason behind their favorable view of Lehman Brothers
 - Moody's
 - “We view risk management at Lehman Brothers as a significant credit strength for the issuer that supports its current A1, stable rating” (Risk Management Assessment, May 2006)
 - “Credit Strengths for Lehman Brothers Holdings, Inc. are: disciplined growth and diversification efforts; rigorous risk management; exceptional cost discipline; strong institutional-customer flow business; profitable international expansion” (Credit Opinion, June 2006)
 - “According to Moody’s, Lehman Brothers continues to be among the best Financial Services Firms at managing liquidity and market risks, which has contributed to the firm’s relatively low earnings and margin volatility” (Press release announcing change in outlook from stable to positive, June 2006)
 - S&P
 - “Liquidity and risk management are strong so that a cyclical downturn in the securities industry should not pose major problems for Lehman Brothers” (Summary Credit Opinion, June 2006)
 - Fitch
 - “Market and credit risks are conservatively managed. (...) Risk governance is well-developed and follows industry best practices” (Credit Analysis, July 2006 (draft))
 - DBRS
 - “... the Company’s strong and sustainable earnings performance also reflects the consistent disciplined management of expenses and risk during a period of rapid expansion” (DBRS, September 2006)

Risk Analysis and Quantification

LEHMAN BROTHERS

Risk Management Integrated Framework

The Three Core Functions of Risk Management are

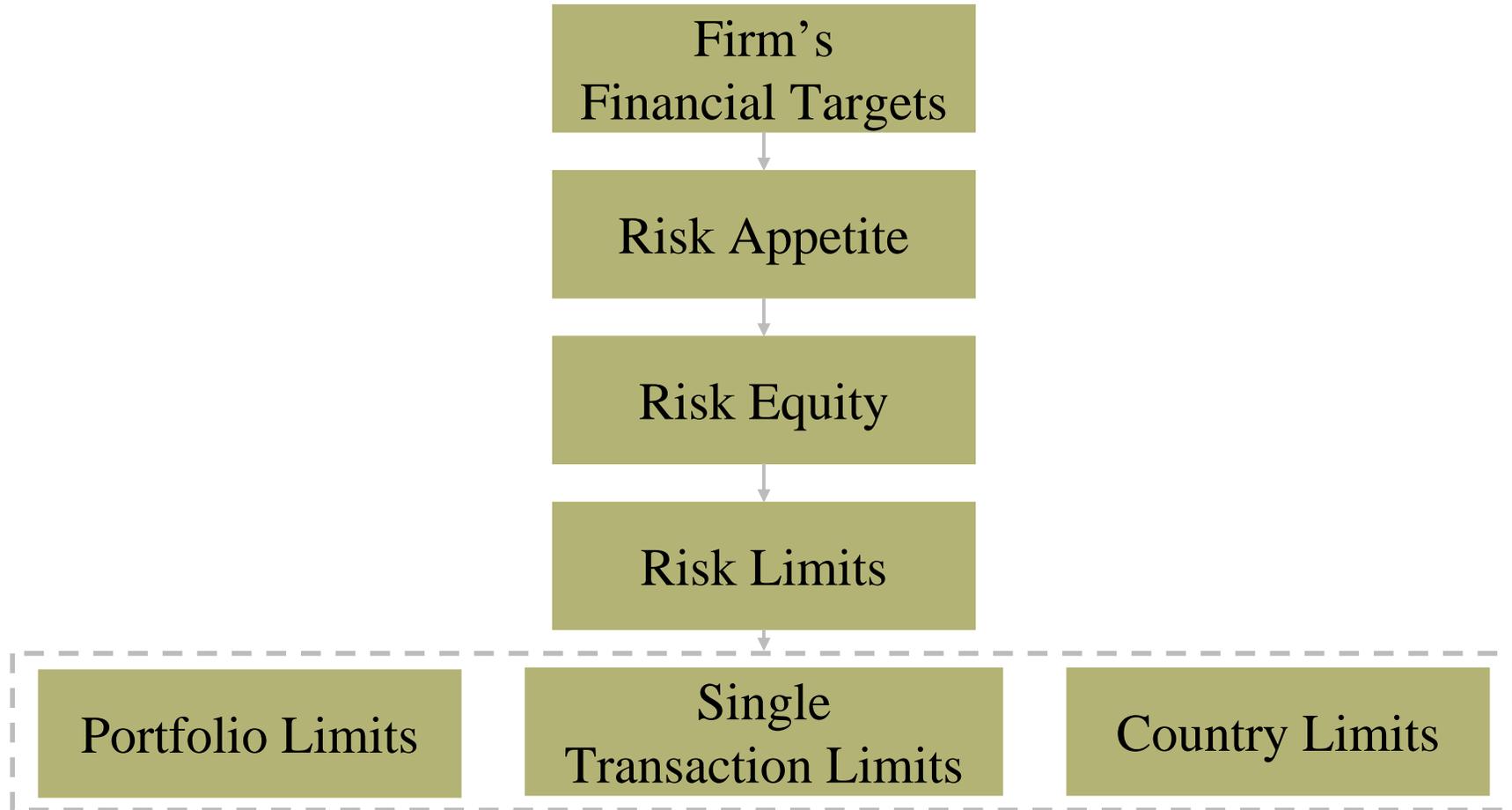
1. Understanding and identifying all risks
2. Ensuring that appropriate limits are in place for all transactions and products
3. Protecting the Firm against “catastrophic” loss



1. Have metrics to measure the risk for all products
2. Define a “Risk Appetite”
3. Have the ability to measure and monitor “tail risk”

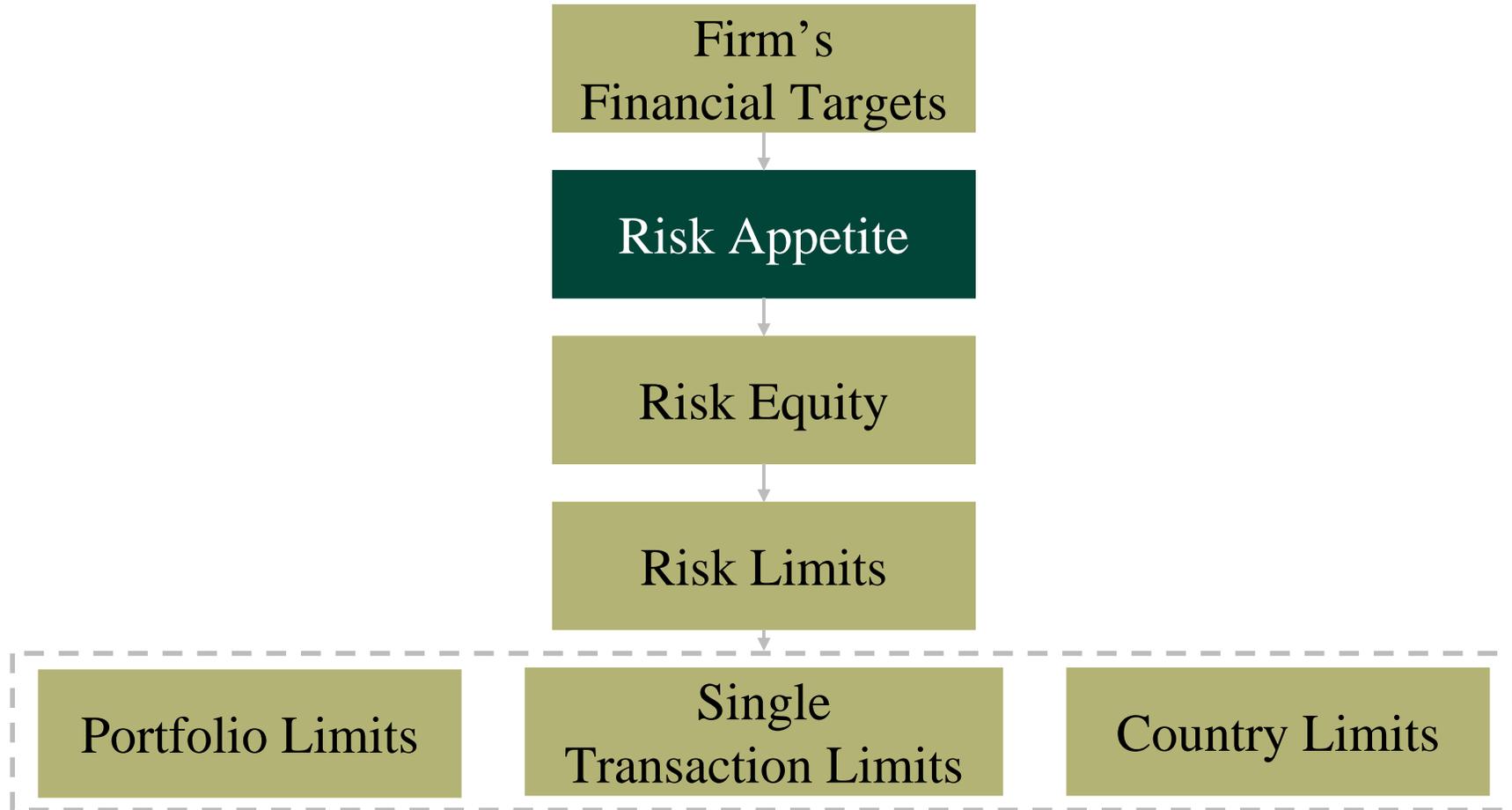
Risk Management Integrated Framework

- ◆ Multi-Tiered
- ◆ Integrated Risk Framework



Risk Management Integrated Framework

- ◆ Multi-Tiered
- ◆ Integrated Risk Framework



Risk Management Integrated Framework

Risk Appetite

- ◆ The risk appetite represents the quantity the Firm is “prepared to lose” in a year from market, event and counterparty credit risk
- ◆ The risk appetite framework begins with the Firm’s financial targets and is designed to balance risk and return
 - Our aim is to deploy enough risk in our businesses to maximize returns
 - While limiting risk to ensure we meet our financial targets
- ◆ Significant factors driving risk appetite include
 - Base revenue assumptions
 - An estimate of the loss of revenues from non-risk taking activities
 - A minimum acceptable ROTE
 - Compensation adequacy

Risk Management Integrated Framework

Risk Appetite

- ◆ We start with our financial targets
- ◆ We take into account a potential simultaneous slowdown in customer flow and banking activities (origination / advisory) which would negatively impact our financial targets since revenue shortfalls can also come from non-risk taking activities
- ◆ Then we subject ourselves to two constraints
 - Maintaining a minimally acceptable annual ROTE
 - Ensuring compensation adequacy including maintaining sufficient headcount to protect the franchise for the long-term

Risk Management Integrated Framework

Risk Appetite – The Center of Our Approach to Risk

- ◆ The risk appetite represents the quantity the Firm is “prepared to lose” in a year from market, event and counterparty credit risk. It is defined and measured at a 95 percent level of confidence

Confidence Interval and Time Horizons

Daily VaR

- ◆ 95% confidence
- ◆ One day horizon

Risk Appetite

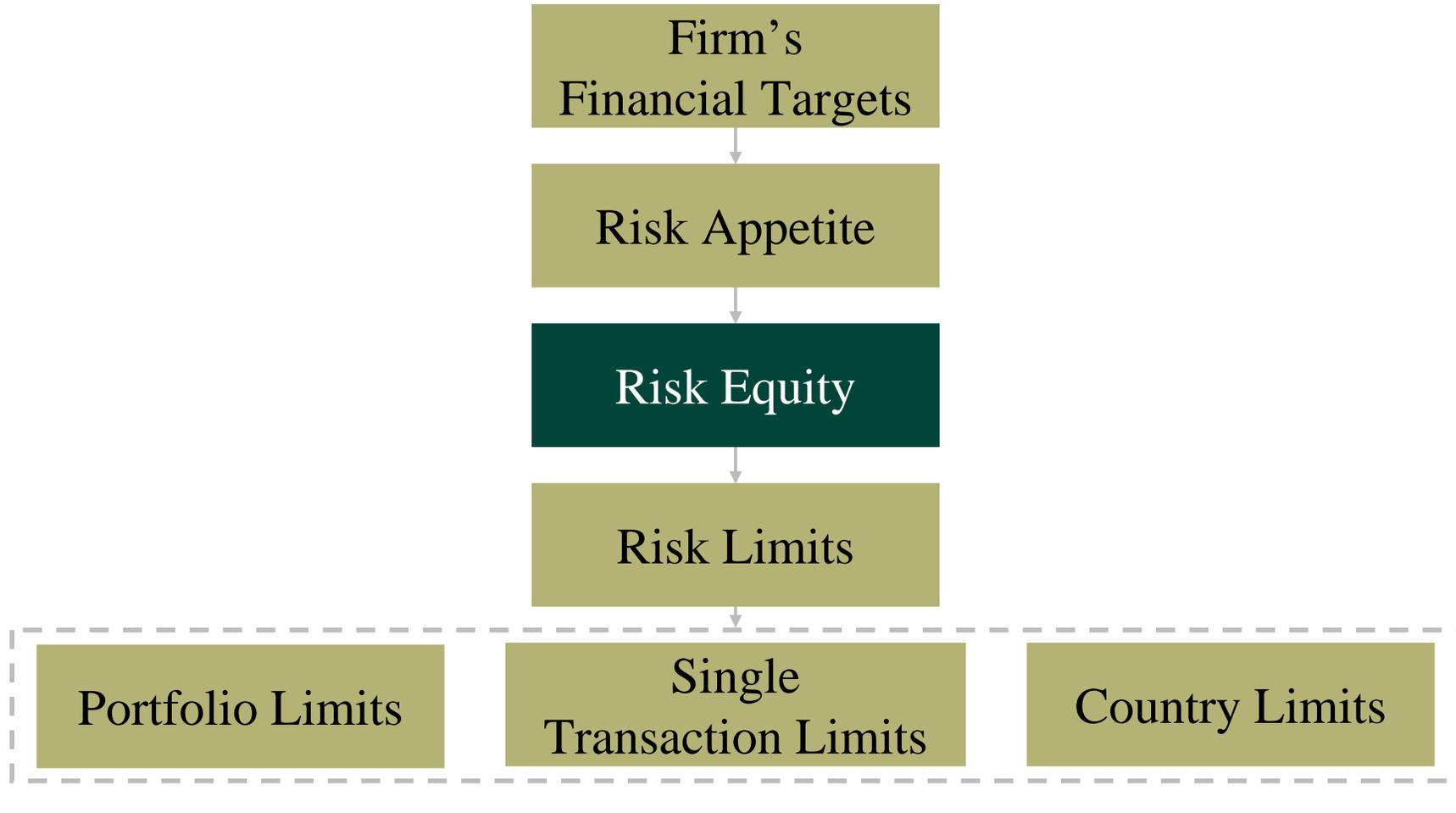
- ◆ 95% confidence
- ◆ One year horizon

Equity Requirement

- ◆ 99.5% confidence
- ◆ One year or longer horizon depending on the nature of the trade

Risk Management Integrated Framework

- ◆ Multi-Tiered
- ◆ Integrated Risk Framework

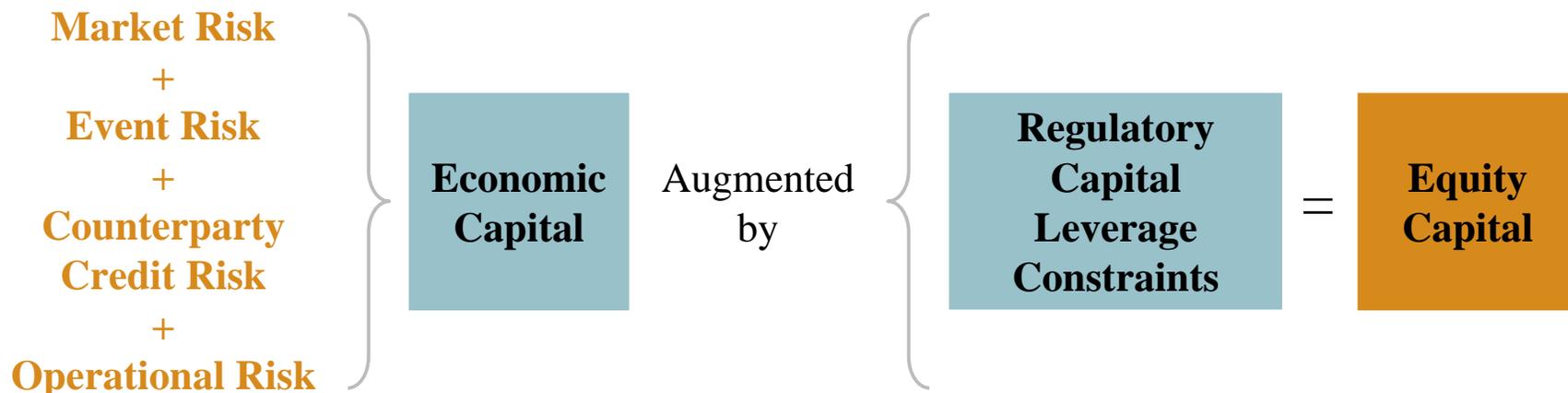


Risk Management Integrated Framework

Risk Equity

- ◆ The equity capital the Firm requires is the economic capital required to protect the Firm against market, event, counterparty credit and operational risks augmented by capital requirements due to external constraints
 - To the extent leverage or regulatory equity is an overriding constraint for the Firm, businesses are charged incremental equity on top of their economic (risk) equity

Equity Capital – Economic Capital and Regulatory Capital



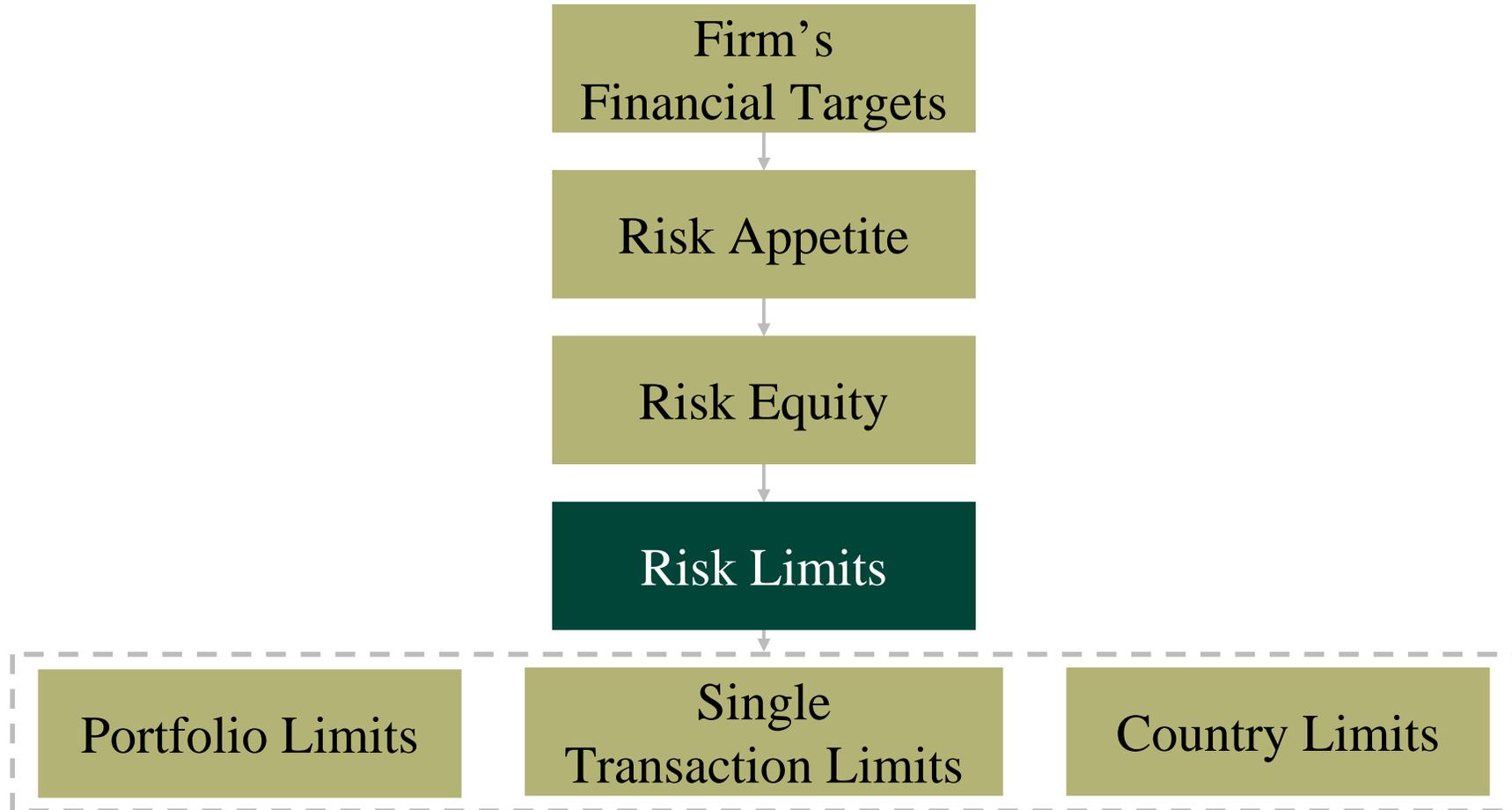
Risk Management Integrated Framework

Risk Appetite Usage

- ◆ Risk appetite usage is measured on a globally consolidated basis and reported on a daily basis against our risk appetite limit
- ◆ Risk appetite usage is composed of
 - Market Risk
 - Measures the potential mark-to-market loss on all positions from adverse market moves
 - We use historical simulations which are “walk-backs” through time to determine what would have been the P&L impact on today’s portfolio if we relived each day over the past four years. We weight the data giving more weight to recent market moves while at the same time giving less weight to market moves further back in time
 - This approach allows us to avoid making assumptions about distributions, about diversification, about relative risk factor weightings
 - In order to determine the reasonableness of the market risk measures, we do back-testing, comparing the market risk generated for the portfolio using the historical simulation approach to its actual trading P&L
 - Event Risk
 - Measures stress and “gap risks” which go beyond potential market risk losses. We measure these risks using statistically measurable stress analyses which capture losses associated with
 - Downgrades for high grade and defaults for High Yield loans, bonds and convertibles
 - Defaults for sub-prime mortgage loans
 - Property value losses on real estate
 - Dividend risk for equity derivatives
 - Deal break risk for merger arbitrage positions
 - Gap risk for fund derivatives
 - Counterparty Credit Risk
 - Measures the potential loss the Firm can suffer due to non-performance of our counterparties on forward settlements, financing and derivative transactions

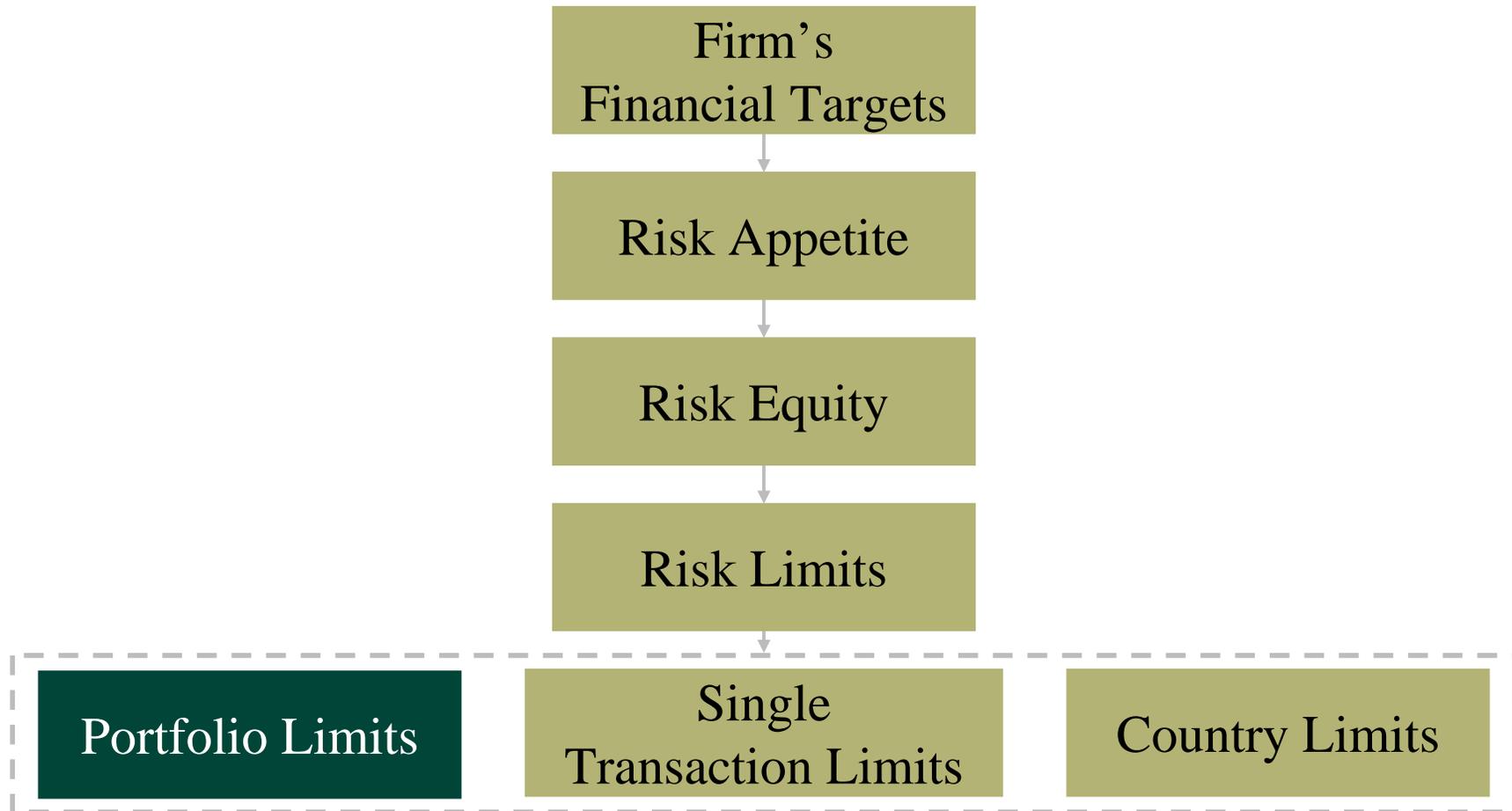
Risk Management Integrated Framework

- ◆ Multi-Tiered
- ◆ Integrated Risk Framework



Risk Management Integrated Framework

- ◆ Multi-Tiered
- ◆ Integrated Risk Framework



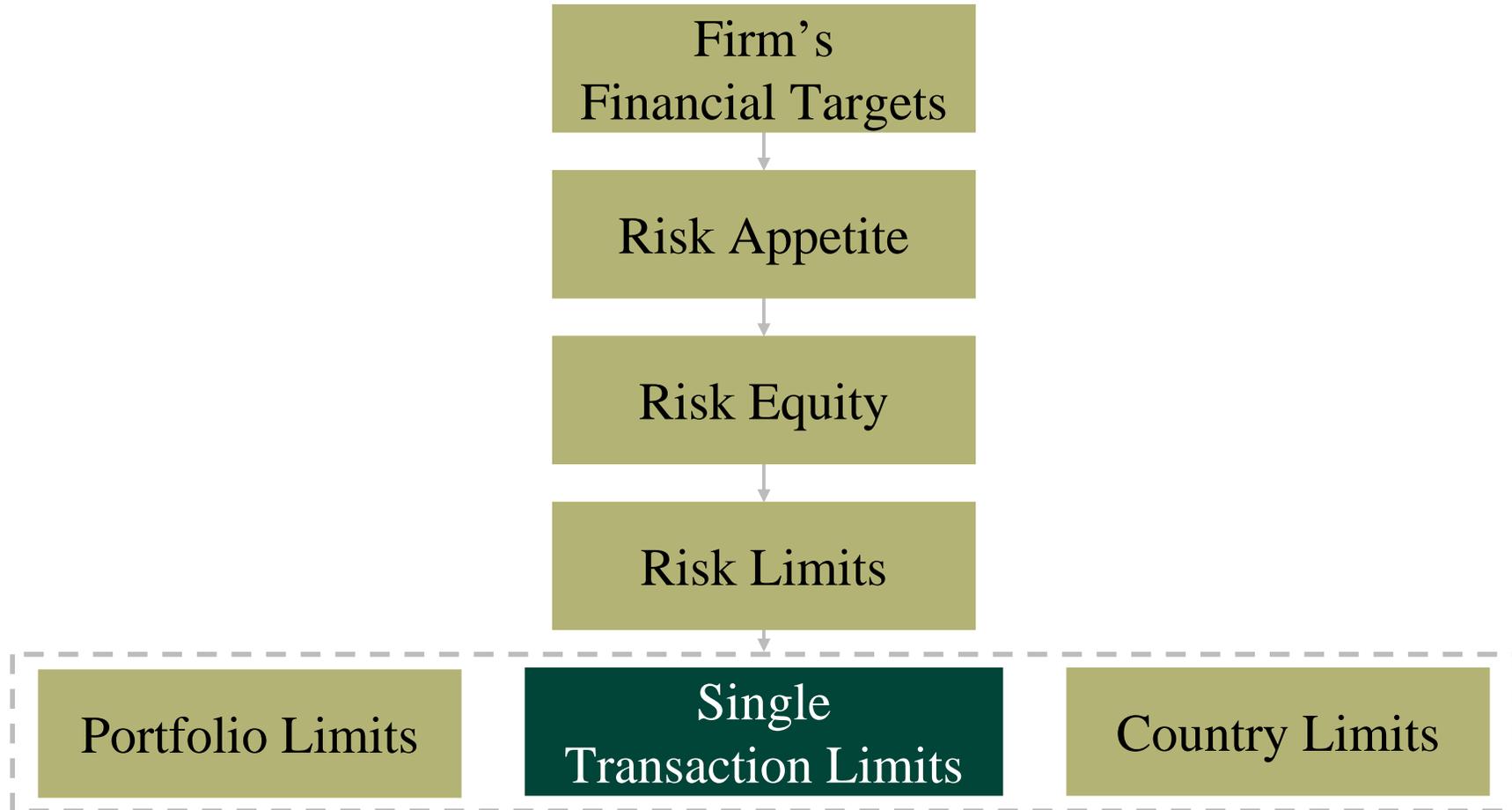
Risk Management Integrated Framework

Risk Limits

- ◆ The overall philosophy of our Firm is that we have a zero tolerance level for ignoring limits and internal processes
 - ◆ Disciplinary actions for limit breaches include compensation adjustment or terminations
 - ◆ The Chief Risk Officer has the authority to approve exceptions. The Global Heads of Market Risk and Credit Risk will make recommendations
 - ◆ Risk Appetite Limits
 - The overall risk appetite limit is recommended by the Chief Risk Officer and approved by the Executive Committee on an annual basis and is reviewed quarterly for requisite changes
 - Limits are cascaded down to divisions, businesses and regions. Trading desk heads further allocate limits to individual desks
 - Limits are monitored daily
 - ◆ Credit Limits
 - All counterparties are given internal ratings
 - Every counterparty has a limit which is subdivided into product limits
 - The largest counterparties by industry, region and product are reviewed on a quarterly basis
 - All counterparties rated below “A” are formally reviewed on an annual basis
-

Risk Management Integrated Framework

- ◆ Multi-Tiered
- ◆ Integrated Risk Framework



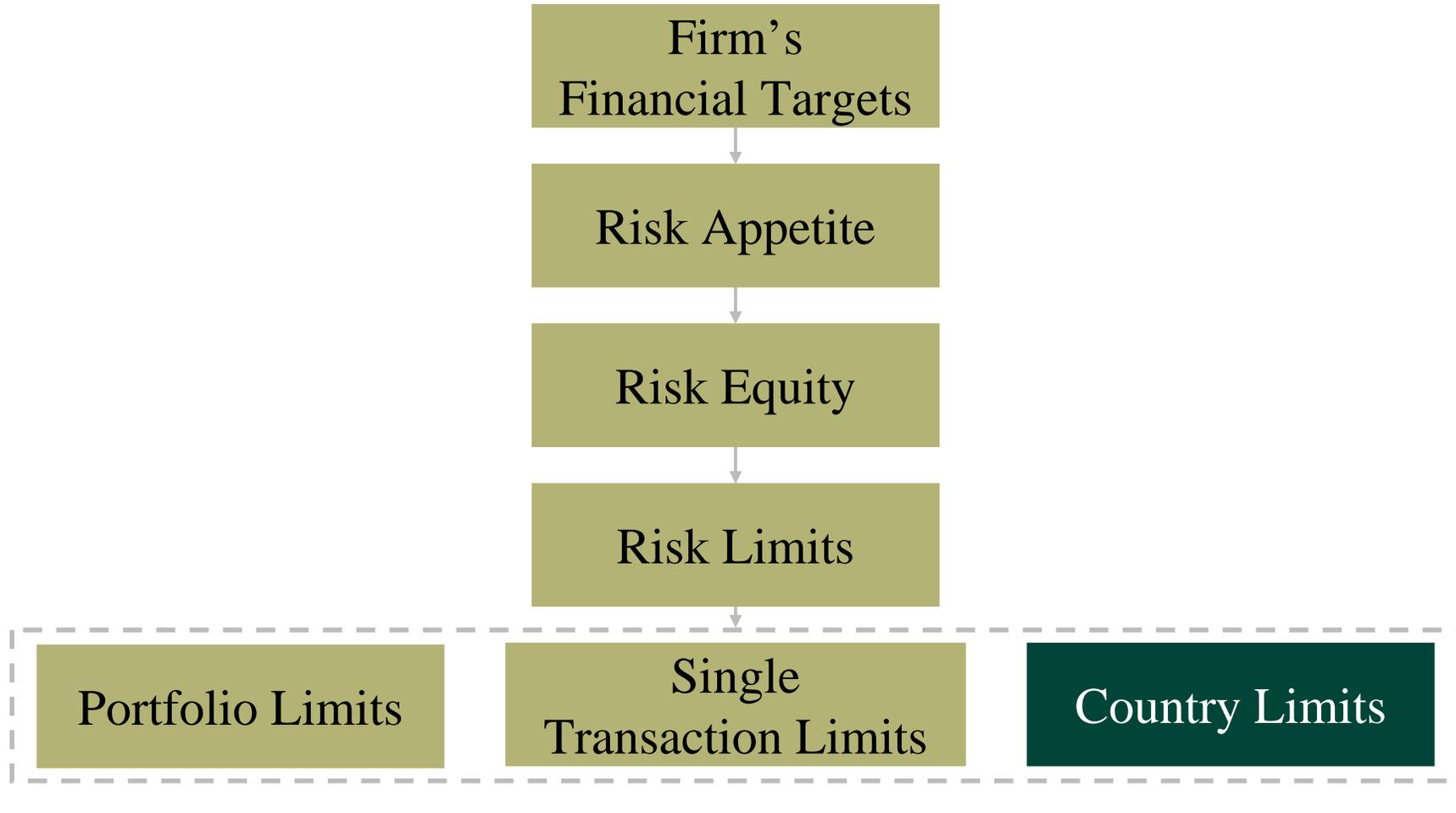
Risk Management Integrated Framework

Single Transaction Limits

- ◆ The Firm operates under a comprehensive regime of limits for risk which relate to the aggregate portfolio of transactions
- ◆ The Single Transaction Limit framework limits the size of single transactions even if a transaction can be accommodated within these aggregate limits
- ◆ We want to limit the maximum loss we could incur to any one name in order to avoid negative publicity and incur decreased confidence in the Firm's risk controls
- ◆ The Commitments Committee has the authority to approve transactions within these limits
- ◆ Executive Committee approval is required in rare circumstances where transactions could exceed these limits

Risk Management Integrated Framework

- ◆ Multi-Tiered
- ◆ Integrated Risk Framework



Risk Management Integrated Framework

Country Limits

- ◆ Limits are set on a country basis for non-G10 countries
- ◆ All countries are tiered according to
 - Political and social stability
 - Macro fundamentals / creditworthiness
 - Size and liquidity of markets
- ◆ Limits are set on an Estimated Potential loss basis
- ◆ This process limits losses arising from a crisis in a country or a region
- ◆ Encourages prudent risk taking

Risk Management Integrated Framework

Stress Tests

- ◆ Stress tests and scenario analyses are performed regularly to evaluate the potential P&L impact on the Firm's portfolio of abnormal yet plausible market conditions
 - Analyses of movements in interest rates, stock prices, FX, volatility, etc., are run over a wide range of possible scenarios to determine the impact on the current portfolio of these extreme instantaneous shocks
 - These analyses are conservative because they do not allow for re-hedging or selling down a position either actively or through the automatic execution of existing stop-losses
 - ◆ Our stress tests are run regularly on a suite of scenarios, including
 - Re-runs of historical episodes of extreme market moves, for example
 - 9/11 terrorist attacks
 - Russia default contagion and LTCM
 - November 2001, volatile bond market
 - October 1987, stock market crash
 - Hypothetical scenarios due to shocks that have some probability of occurrence and are driven by macro fundamental shifts, for example
 - Dollar declines due to the current account deficit
 - Oil price shocks
 - Yield curve steepening due to potential inflationary expectations
 - Credit spreads widening due to an increase in the overall amount of leverage in the system
 - Other ad-hoc hypothetical scenarios
 - ◆ We subject both our trading and counterparty portfolio to stress tests
-

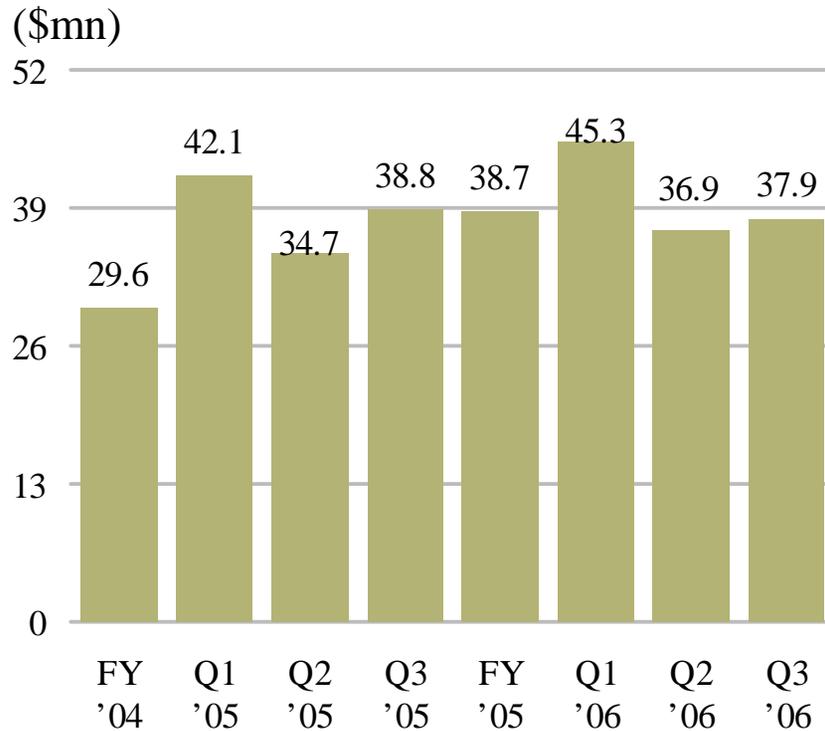
Review of Results

LEHMAN BROTHERS

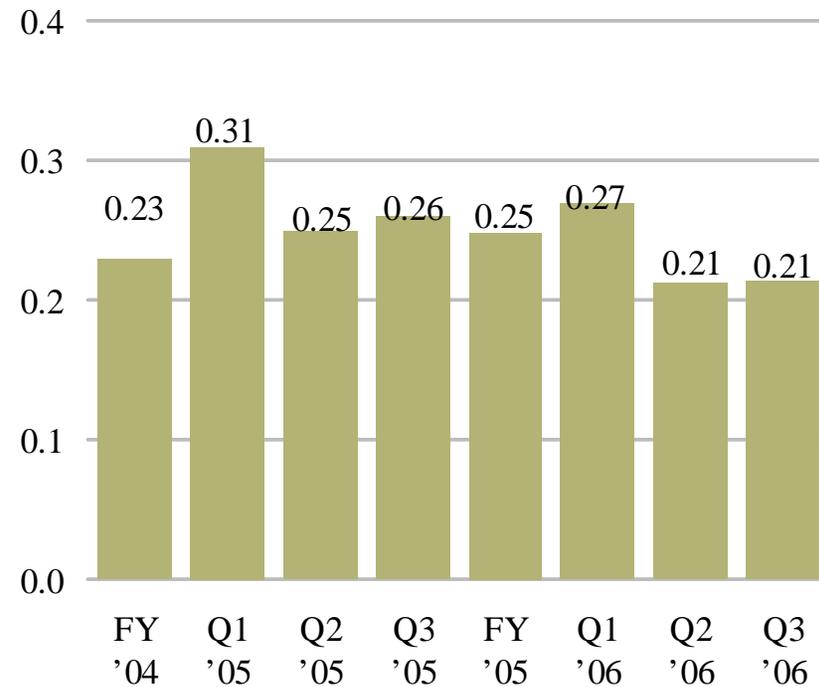
Review of Results

- ◆ Our franchise has grown significantly in the past few years, increasing our risk-taking capacity
- ◆ Relative to our tangible equity, risk is now lower now than a few years ago

VaR – Historical Simulation



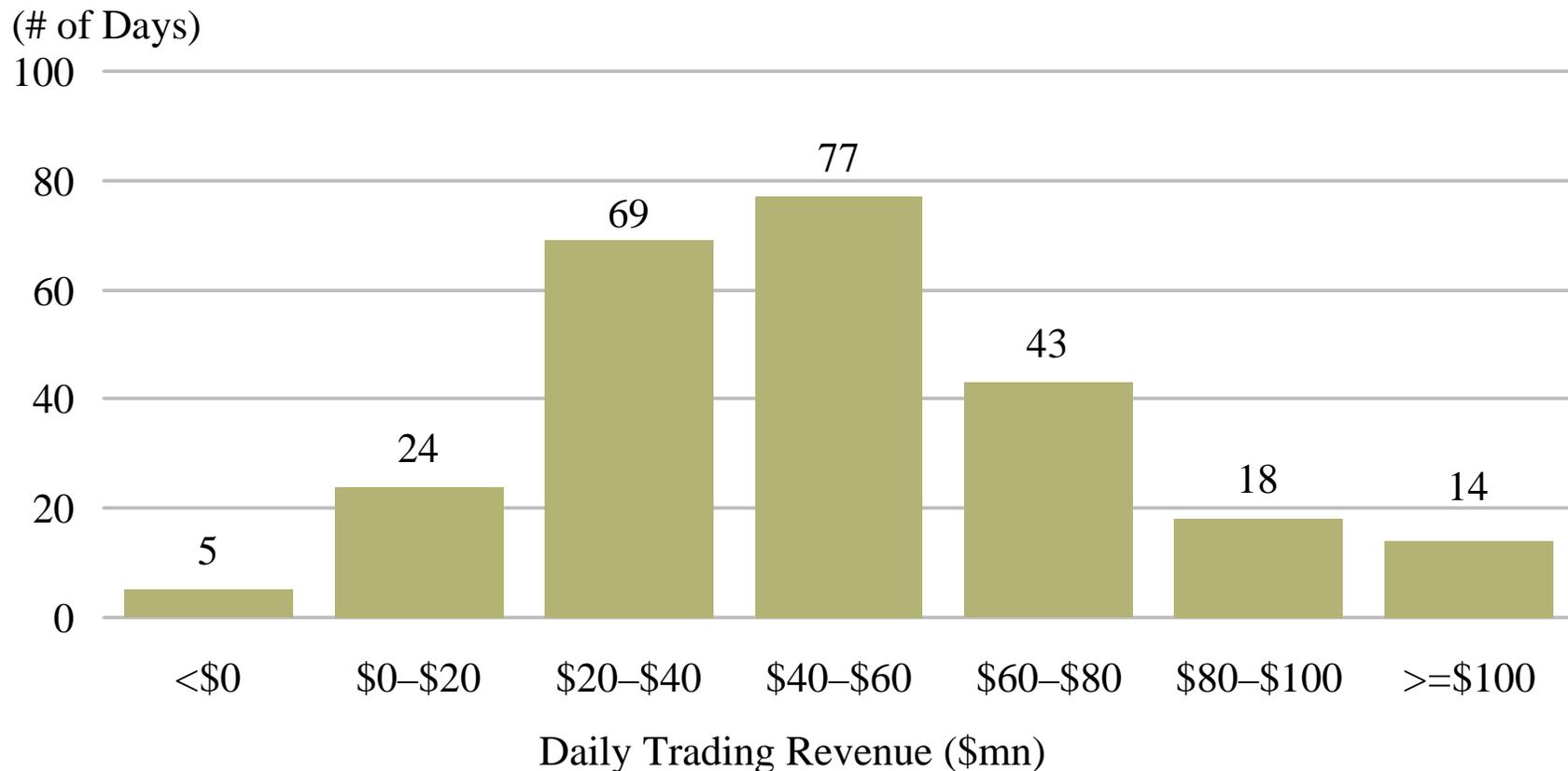
Historical Simulation VaR as % of Tangible Equity



Review of Results

- ◆ Average daily trading revenue was \$50mn over the past year
- ◆ Consistent with our conservative risk profile, we had only five negative trading days

Daily Trading Revenue Distribution (September 2005 through August 2006)



Review of Results

- ◆ We continue to be prudent in our approach to counterparty credit risk
 - We have a very low tolerance for delays on receiving collateral, where applicable
 - We give very close scrutiny to the value of customer collateral posted against margin loans
- ◆ We have a very high quality credit portfolio
- ◆ 97.7% of our counterparty exposure is in investment grade names
- ◆ The bulk of our exposure is to banks and other financial institutions
- ◆ Hedge Fund exposure represents 1% of our total portfolio
- ◆ 92.6% of our exposure is in the U.S., Canada and Western Europe

Current Credit Exposure Trend by Rating

(US\$ million)

	Ratings					Percentages				
	3Q '05	4Q '05	1Q '06	2Q '06	3Q '06	3Q '05	4Q '05	1Q '06	2Q '06	3Q '06
AAA	3,745	3,569	4,347	5,506	5,096	20.5%	19.3%	22.5%	20.5%	21.3%
AA	6,163	6,763	6,643	11,929	10,469	33.7%	36.5%	34.3%	44.5%	43.8%
A	5,966	5,933	6,073	6,987	6,140	32.6%	32.0%	31.5%	26.1%	25.7%
BBB	1,807	1,825	1,826	2,010	1,658	9.9%	9.8%	9.5%	7.5%	6.9%
BB	467	314	336	308	422	2.6%	1.7%	1.8%	1.1%	1.8%
B or Lower	155	135	83	82	138	0.8%	0.7%	0.4%	0.3%	0.5%
Total	18,304	18,539	19,308	26,823	23,923	100.0%	100.0%	100.0%	100.0%	100.0%

	3Q '05	4Q '05	1Q '06	2Q '06	3Q '06
Investment Grade	96.6%	97.6%	97.8%	98.5%	97.7%
Below Investment Grade	3.4%	2.4%	2.2%	1.5%	2.3%
	100.0%	100.0%	100.0%	100.0%	100.0%

Note: Does not include money market deposits.

Conclusion

LEHMAN BROTHERS

Conclusion

- ◆ We have a strong culture of Risk Management throughout the Firm
 - ◆ Our franchise is to facilitate clients
 - ◆ We have developed a very robust and comprehensive framework for thinking about and managing all forms of risk
 - Our powerful risk and equity allocation tools help guide the Firm in its overall management and decision making
 - ◆ We are prudent toward our approach to credit risk which has resulted in a very high quality and well diversified credit portfolio
 - We have very low tolerance for delays on receiving collateral, where applicable
 - We give close scrutiny to the value of customer collateral posted against margin loans
 - ◆ Our approach is to mitigate risk through various hedging strategies, and follow a model of credit facilitation where we act as a conduit between our clients and the capital markets, rather than as the ultimate holder of the risk
 - ◆ Our overall Risk Management philosophy of conservatism and prudence has been an important factor in our improving credit spreads, ratings and credit worthiness
-