Confidential ***Presentation to:***

Fitch

Risk Management Presentation

April 7, 2006

LEHMAN BROTHERS

Agenda

Agenda

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  - Committee Structures
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  - Organization of the Global Risk Management Division
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  - Risk Limits
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Risk Governance

Risk Philosophy

- Risk Management is one of our core competencies
- An essential part of Lehman Brothers' approach to Risk Management, is a strong internal control environment with multiple overlapping and reinforcing elements
  - It is multi-tiered and involves many areas of the Firm
- Risk Management is more than measuring and reporting risk
- Our approach applies analytical rigor overlaid with sound practical judgment
- One key feature which differentiates us from our peers is our integration of Market and Credit Risk Management
  - Allows us to leverage people, analytics, systems, data and information flows
- Risk Management works proactively with the risk-taking areas of the Firm before transactions occur
  - To ensure the least risky deal structure is executed
  - To ensure risk mitigants are in place, including getting appropriate levels of collateral
- Our focus is balancing risk vs. return
  - We want to help ensure Lehman Brothers' risk appetite is deployed in the most efficient way
- Risk Management
  - Develops risk policies and procedures
  - Develops risk measurement methodologies
  - Sets limits
  - Tracks actual usage against limits
  - Evaluates valuation models
- At the end of the day nothing is fool-proof. While there is no guarantee against loss, we can minimize the probability of loss
  - Our first line of defense is our culture
  - We set the tone, right from the top
  - We have developed a comprehensive internal control environment, to mitigate risk to the greatest extent possible

Risk Philosophy

- Protecting the franchise is, and has been, at the heart of the Firm's culture
- The Firm has committed many of its best people to its control infrastructure. We also reward those people whose job it is to protect the Firm, so we can continue to attract great people to these roles
- We have also invested significantly in technology to support our control infrastructure
- Our policy of compensating employees with a large portion of deferred stock has raised the level of employee ownership to around 30%, so employees think and act like owners
  - For our senior managers, the change in stock price is far more material to their net worth than their annual compensation, incenting them to take the long view, and maintain tight controls
- Our commitment to the highest standards of governance and ethical behavior is grounded in our recognition that nothing is as valuable as our reputation, and is a core part of who and what we are as a Firm

Risk Philosophy

Key Risk Oversight

- Dick Fuld chairs the weekly Capital Markets meeting
  - Composed of the executive committee, the Chief Strategist, the Chief Economist, and the Chief Risk Officer
  - Serves to frame our risk views in the context of the global market environment
- The Firm's Risk Committee meets weekly and consists of the Executive Committee, the Chief Risk Officer and the Chief Financial Officer. The weekly meeting includes discussions of the Firm's top risks. Topics include
  - Risk Appetite limits utilization
  - Value-at-Risk (VaR) limits utilization
  - Counterparty credit risk exposures by region, product, sectors and ratings and top investment grade and non-investment grade names
  - Large exposures
  - Commitments including the potential pipeline
- 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

Committee Structures

- Lehman 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:

Executive Committee	**Management Oversight Committees**
Management Committee	
Operating Exposures Committee	
Finance Committee	
Capital Markets Committee	
Risk Committee	
Commitment Committee	**Firmwide Transaction Approval Committees**
Commitment Risk Committee	
Bridge Loan Committee	
Investment Committee	
Fairness Opinion Committee	
IMD Product Review Committee	
New Products Committee	
Complex Structured Finance Transactions Committee	
Loan Participation Committee	**Business Level Transaction Approval Committees**
High Yield Credit Committee	
High Grade Credit Committee	
Structured Finance Committee	
Equity Commitment Committee	
Global Equity Risk Committee	

Committee Structures

Transaction Approval Committees

- There are several firm-wide transaction approval committees. Each firm-wide committee includes representatives from a number of front offices and support functions, such as Risk Management, Finance and Credit Research
- The Firm's **Commitment Committee** reviews and approves the Firm's participation in all proposed debt and equity offerings and financing transactions
- The **Bridge Loan Committee** reviews and approves those transactions involving the commitment of interim financing by the Firm
- The Firm's **Investment Committee** reviews and approves all investments or divestitures of principal investments, including those entered into by the Firm's Private Equity funds
- The Firm has loan related committees (**High Yield**, **High Grade, and Loan Participation Committees**) which also must review and approve any lending related transactions when the Firm will underwrite or take a position (including unfunded lending facility commitments) and underwriting of bond offerings
- The **Equity Commitment Committee** reviews and approves the Firm's participation as an underwriter in an equity offering
- The **Structured Finance Committee** reviews and approves the Firm's participation as an arranger, agent or underwriter in structured finance transactions
- The **IMD Product Review Committee** reviews and approves the distribution of product through the Private Investment Management division, including suitability requirements
- The **New Products Committee** determines whether the Firm will commit to market a new product or enter into a new business. Particular areas of focus include all aspects of risk (legal, credit, tax, finance, operational, sales, documentation and market) and awareness of the product or business throughout the Firm

Committee Structures

Approval Transaction Committees

New Products Committee

- The Firm's **New Products Committee** is chaired by the Firm's Chief Legal Officer. The Committee determines whether the Firm will commit to market a new product or enter into a new business. Particular areas of focus include all aspects of risk (legal, credit, tax, finance, operational, sales, documentation and market) and awareness of the product or business throughout the Firm. The budget for any new product, including capital required, must be approved as part of the budget for the business unit proposing the product
- The New Products Committee is composed of senior Firm employees representing support areas (Operations, Systems, Risk Management, Accounting, Treasury, Tax, Legal, Compliance, Credit, Audit, Documentation) and core businesses such as Investment Banking, Fixed Income, Equities, Private Client Services and Derivatives
- Products and / or businesses that are reviewed by the Committee have the following characteristics
  - Products that have not been offered to the Firm's clients and counterparties previously, or over the last two years, in their current form or in a substantially similar form; or
  - Variations on existing products that significantly alter the product's risk profile; or
  - The trading or offering of transactions by existing businesses in a substantially different manner or through different legal entities; or
  - Businesses that have not been conducted by the Firm previously, or over the last two years; or significant changes in the operation or risk profile of an existing business; or
  - Marketing an existing product into a new country
- Review / Approval
  - If approved, the Committee helps to determine which control / support areas the business group needs further assistance from to complete the new product / business integration. Off-line working groups are set up, if appropriate, to address issues specific to the product. After the off-line work is complete the product may need to come back to Committee for final approval

Committee Structures

Proposed Transaction Approval Committee Responsibilities

	Type of Risk											
Committee	**Credit**	**Investment Merits**	**Reputation**	**Legal**	**Syndication**	**Market**	**Rating Agencies**	**Funding**	**Use of Capital**	**Operational**	**Risk Limits**	**Return on Risk**
High Grade Credit Committee	✓				✓	✓			✓		✓	✓
High Yield Credit Committee	✓				✓	✓			✓		✓	✓
Structured Finance Committee	✓				✓	✓			✓		✓	✓
Equity CC / Global Equity Risk Committee		✓			✓	✓					✓	✓
Loan Participation Committee									✓			✓
IMD Product Review Committee		✓	✓	✓	✓							
New Products Committee			✓	✓						✓		
Complex Structured Finance Transaction Committee			✓	✓								
Commitment Committee	✓	✓	✓	✓	✓	✓			✓			
Bridge Loan Committee	✓		✓	✓	✓	✓	✓	✓	✓			
Investment Committee		✓	✓								✓	✓
Commitment Risk Committee	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

1. *If above applicable transaction limits.*

Risk Management

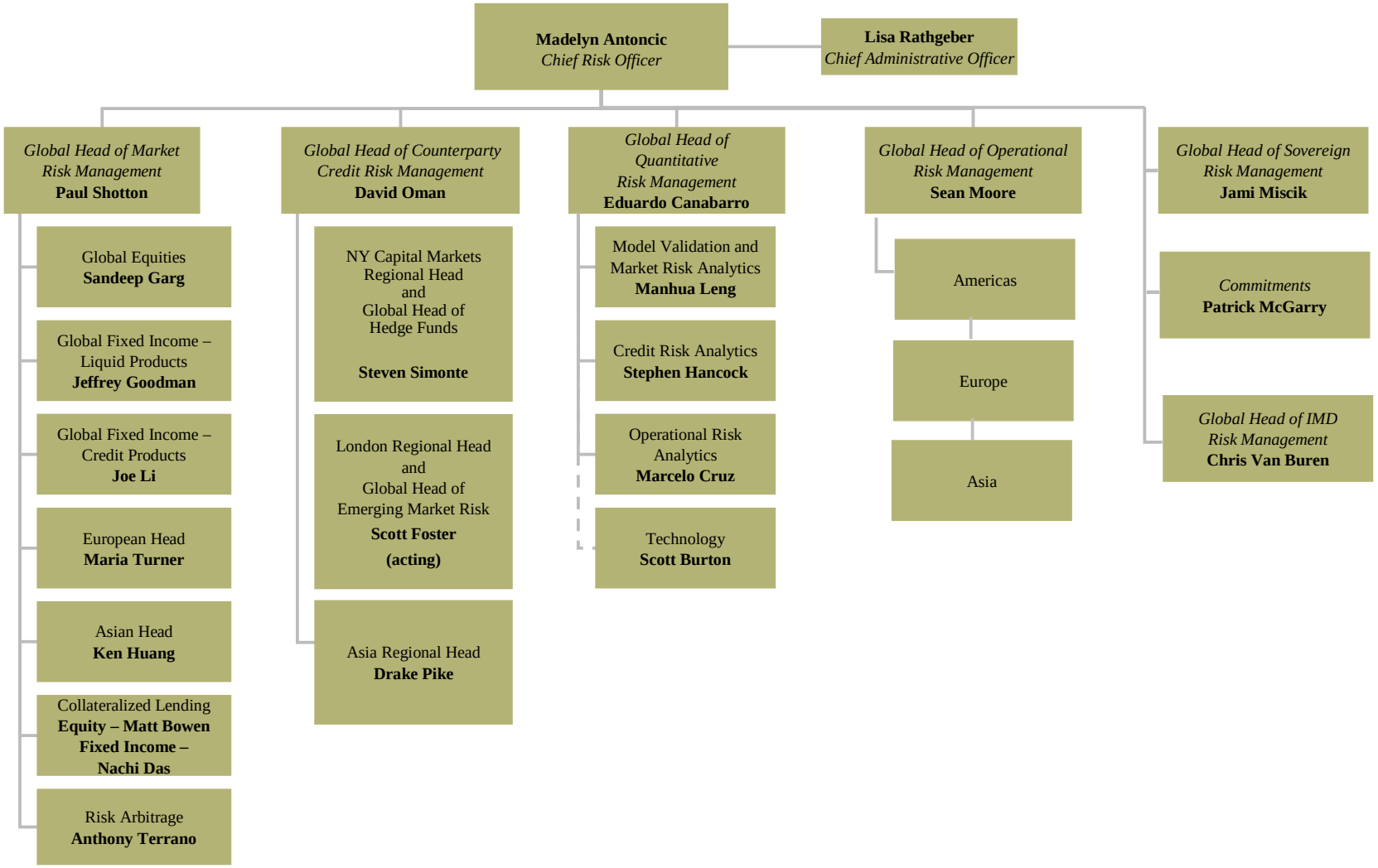
Independence of the Risk Management Function

Risk Management is Independent from Trading

- The Global Risk Management Division is independent of the trading areas
- The Chief Risk Officer, Madelyn Antoncic, Ph.D., 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 Chief Risk Officer has put in place Global Heads for each department with the Global Risk Management Division
  - Global Head of Market Risk Management
  - Global Head of Credit Risk Management
  - Global Head of Quantitative Risk Management
  - Global Head of Operational Risk Management
  - Global Head of Sovereign Risk Management
  - Global Head of IMD Risk Management
- Trading management reports to the global heads of Fixed Income (Michael Gelband) and Equities (Bart McDade) who report to the President and Chief Operating Officer (Joe Gregory). Outside the U.S., trading management, as well as Risk Management, is "matrixed" reporting both to global heads and regional heads

Organization of the Global Risk Management Division

- Risk Management is a global, integrated function under the leadership of the Chief Risk Officer, Madelyn Antoncic. The Global Risk Management Department consists of 280 professionals, with 173 risk managers and 107 technologists



Organization of the Global Risk Management Division

Risk Management Qualifications

- The Global Risk Management Division ("GRMD") consists of 280 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
  - 50 Market Risk
  - 62 Credit Risk
  - 24 Quantitative Analysis / Model Validation
  - 17 Quantitative Reporting
  - 5 Operational Risk
  - 3 Sovereign Risk
  - 3 IMD Risk
  - 7 Admin
  - 107 Technology
- Excluding technologists and administrative staff, we have 166 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	Operational Risk	Sovereign Risk	IMD Risk	Total
PhD	50%	25%	0%	62%	0%	50%	33%	0%	19%
Masters	0%	53%	41%	33%	13%	25%	67%	100%	41%
Bachelors	50%	23%	55%	5%	81%	0%	0%	0%	38%
Other	0%	0%	4%	0%	6%	25%	0%	0%	3%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Percentage of former traders, desk quants and business experience	**50%**	**30%**	**23%**	**24%**	**n/a**	**50%**	**67%**	**33%**	**25%**

Internal Control Environment

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 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 designed to develop a better understanding of the Firm by the SEC and is now part of the CSE process
- The NYSE and CBOT conduct annual examinations of the Firm's compliance, financial and operations areas. In addition the other exchanges as well as the SEC conduct examinations. Over the past several years, there have not been any significant findings
- In addition, 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
- In response to additional regulatory requirements across the industry, the Firm has significantly increased the size of its compliance function over the past several years

Market Risk Management

Responsible for

- Ensuring all market risks are identified, understood, measured, monitored and captured by an appropriate metric
- Active risk exposure consulting with businesses
- Active consulting role in risk capital allocation / risk-adjusted performance assessment
- Assisting senior management in the dialogue with rating agencies and regulatory bodies
- Administering limits and management action triggers
- Monitoring and reporting of the market risk of trading exposures
- Aggregating and analyzing market risk (regionally and globally)
- Communicating large or unusual risk as appropriate
- Developing market risk measurement methodologies in conjunction with Quantitative Risk Management
  - VaR
  - VaR Back Testing
  - Scenario Analysis
  - Event Risk

Credit Risk Management

Responsible for

- Counterparty credit analysis and due diligence
- Assigning and maintaining Internal Risk Ratings (ICR)
- Establishing Credit Limits for each counterparty by family and legal entity, as well as at the individual product levels
- Establishing Country Risk limits
- Preparing Credit Reviews on counterparties which assess the counterparty's strengths and weaknesses, supporting the ICR recommendation and recommended Credit Limits
- Monitoring Counterparty credit exposures on a Current (CCE) and Potential basis (MPE) including usage of Credit Limits
- Monitoring the Credit Portfolio on an ongoing basis which includes
  - Country updates
  - Industry reviews
  - Ongoing review of counterparties
  - Monthly Hedge Fund performance reviews
  - Revising and updating risk ratings as appropriate
  - Understanding portfolio concentrations

Quantitative Risk Management

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
- Subgroups
  - Market Risk Analytics – Develops the quantitative methodologies to measure market risk (VaR, Risk Appetite); maintains the time series database; provides analyses and consultation on market risk quantification
  - Credit Risk Analytics – Develops the quantitative methodologies used to measure credit risk (CCE, MPE); generates exposure, country risk and ad hoc credit risk reports for senior management; provides analyses and consultation on credit risk quantification
  - Operational Risk Analytics – Develops the quantitative methodologies used to measure operational risk; provides analyses and consultation on operational risk quantification
  - Model Validation – Develops and implements the validation standards for the pricing models used in Firm; collects and archives documentation on the pricing models; reviews and approves the pricing models; participates in Model Review Committees (Fixed Income and Equities) with business units, Quantitative Research, Product Control and Technology
  - Risk Technology – Implements the risk models utilized by GRMD; works with all risk groups in the development and implementation of the risk frameworks

Inventory Valuation

- The Model Control Committees are the forum for formal discussions of all model-control-related issues
- The mandate includes
  - Assess the implementation progress and adherence to the control framework
  - Review the pipeline of new models
  - Examine models pending independent reviews and final approval
  - Set priorities for reviews
  - Set model limits, where appropriate
  - Identify models that should be reviewed even in the absence of changes
- The Committees are chaired by the Business Unit and includes as members the Head of and senior members from Quantitative Research, Analytics, Quantitative Risk Management, Product Control, and Technology. Other guests may be invited on specific model issues

Sovereign Risk Management

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
- Monitoring and reporting on crisis events and substantial market shocks in emerging market and selected developed market countries and regions
- Establish country risk appetite limits and internal country ratings
- Advising senior management and business heads on emerging market issues
- Aggregating and analyzing country risk exposures (regionally and globally)
- Assisting Market and Credit Risk Management with the analysis of major market fluctuations resulting from default, currency inconvertibility and transfer risk, currency devaluation, and expropriation of assets

Operational Risk Management

Responsible for

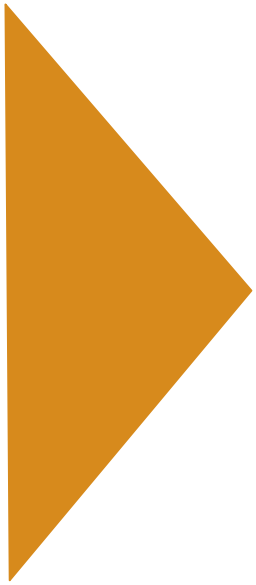
- Ensuring all operational risks are identified, understood, measured and monitored
- Increasing awareness of operational risk throughout the Firm
- Active risk exposure consulting with businesses and support functions
- Resolution of operational risk related issues
- Assisting senior management in the dialogue with internal and external bodies

Risk Analysis and Quantification

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

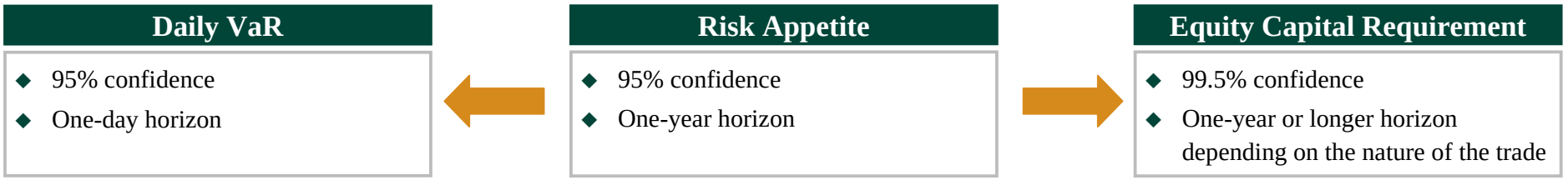
Risk Appetite

- We have established a framework for determining the most appropriate overall level of risk the Firm should be taking
- The framework begins with the amount of revenue the Firm would make in a downturn and is designed to balance risk and return
  - Our aim is to deploy enough risk in our businesses to generate strong cross-cycle returns
  - While at the same time limiting needless risk levels to ensure we meet our financial targets
- We have defined this level of risk as our Risk Appetite, which represents the quantity the Firm is “prepared to lose” in a year from market and counterparty credit risk, as well as from stress events
- 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
- In calculating our overall Risk Appetite, our goal is to maintain a minimally acceptable ROTE and compensation adequacy including maintaining sufficient headcount to protect the franchise for the long-term
- The overall risk limit is driven by Risk Appetite which is approved by the Executive Committee and the Board on an annual basis and is reviewed quarterly for requisite changes

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. Risk Appetite usage is defined and measured at a 95% level of confidence

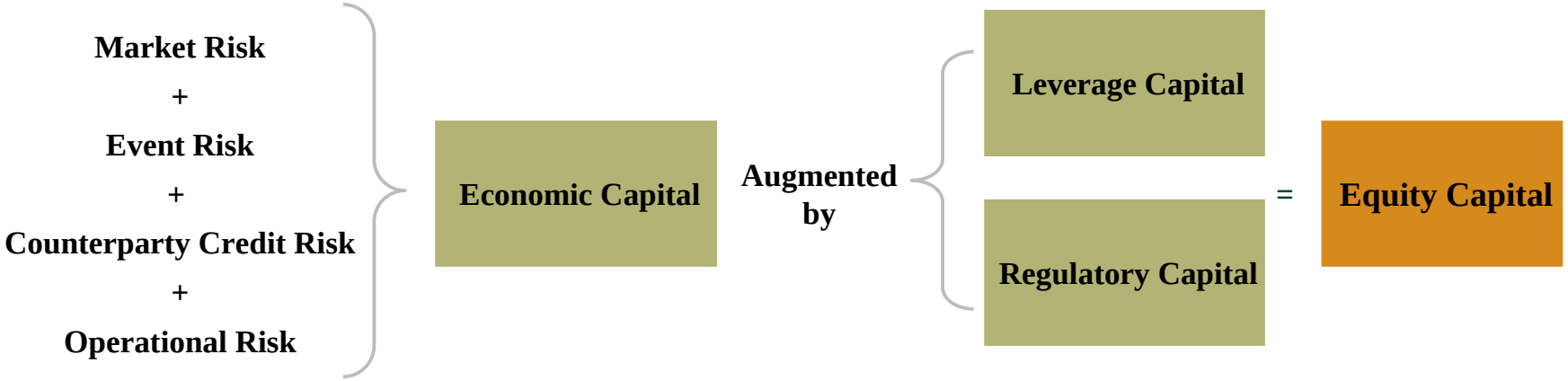


Risk Management Integrated Framework

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 apply an exponential 10% per month decay factor weighting scheme to the data
    - 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 forward settlements, financing and derivative transactions with our customers

Risk Management Integrated Framework

Equity Capital Usage

- For estimating the Equity Capital requirement, the market, event, and counterparty credit risks are measured at a higher confidence level of 99.5% over a one year or longer horizon
  - Market risk
    - To capture cross-cycle market moves, we weigh equally all the historical market data
  - Event risk
    - For property value losses on real estate, a two-year risk horizon is used
- Operational Risk
  - Currently we use a modified CSE Basic Indicator (BIA) approach to estimate the required capital, calculated as 15% x Net Revenues (greater of trailing 4 quarters and budget)
- Leverage Equity & Regulatory Equity
  - Firm's total equity requirement is measured as the greater of the economical capital due to market/event/counterparty credit/operational risk, leverage equity, and regulatory equity
  - To the extent that leverage or regulatory equity is greater than the economical capital, businesses are charged incremental equity on top of their economic capital

Risk Measurement

Market Risk

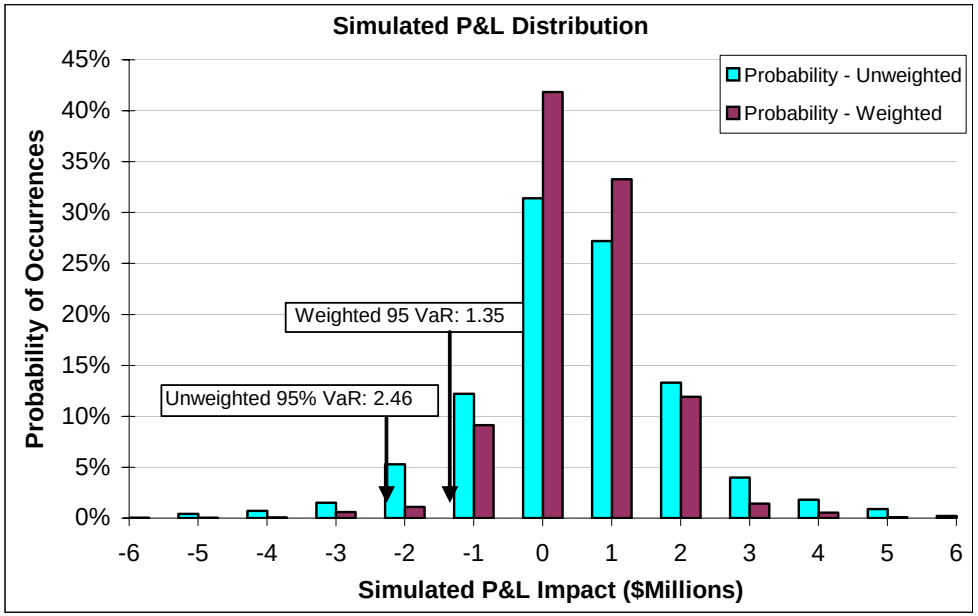
- VaR is an estimate of the potential decline in the value of the Firm's trading positions due to normal market movements over a one-day holding horizon at a 95% confidence level
  - The VaR model accounts for general and issuer-specific risk
  - It also accounts for the fact that the values of certain positions are non-linear with respect to the underlying risk factors with portfolio revaluations for non-linear risk
  - For the general market risk factors (e.g., interest rates, foreign exchange rates, and option implied volatilities) we use historical simulation based on the most recent four years of data. The correlations between general market risk factors are implicitly determined by the historical simulation methodology. The data are weighted to emphasize the most recent period (the Firm currently uses an exponential decay factor of approximately 10% per month)
  - Individual stock price series are used for the simulation of equities risk wherever those series are available. Thus, the equities-risk methodology automatically captures the general and specific risks of stock returns. When there are not enough data on a recently issued stock (e.g., recent IPOs), the Firm employs an interim model using a proxy for the individual stock return – either the closest stock index (when there are fewer than 60 data points) or linear regression model based on the closest index (when there are 60 data points or more)
  - For debt-related instruments, general risk is represented by bond indices constructed for rating-maturity-industry buckets. The specific risk component is simulated based on the characteristics of the empirical distribution of the individual bond residuals with respect to each bucket. All simulated specific risks are assumed to be independent of every other general and specific risk factor in the VaR model
  - We have a high degree of granularity in our estimation of risk evidenced by the fact that we use over 20,000 time series

Risk Measurement

Market Risk - Historical Simulation

- We use the historical simulation – "walk back through time" – approach
  - We estimate the impact that actual daily percentage changes in security prices over the past 4 years would have had on today's position
- Historical Simulation example: Stock position – long $100mm GE stock

Date	Stock Price	Daily Change	P&L Impact ($mm)	Probability	
				Unweighted Scheme	Weighted Scheme
2/28/2006	32.87	-1.4%	(1.35)	0.100%	0.504%
2/27/2006	33.32	0.5%	0.54	0.100%	0.501%
2/24/2006	33.14	-0.4%	(0.36)	0.100%	0.499%
2/23/2006	33.26	-0.4%	(0.39)	0.100%	0.496%
2/22/2006	33.39	0.8%	0.85	0.100%	0.494%
2/21/2006	33.11	-0.7%	(0.75)	0.100%	0.491%
2/17/2006	33.36	0.8%	0.79	0.100%	0.489%
2/16/2006	33.10	-0.3%	(0.33)	0.100%	0.486%
2/15/2006	33.21	0.0%	0.00	0.100%	0.484%
2/14/2006	33.21	0.6%	0.64	0.100%	0.482%
2/13/2006	33.00	-0.1%	(0.09)	0.100%	0.479%
2/10/2006	33.03	1.1%	1.07	0.100%	0.477%
2/9/2006	32.68	0.6%	0.55	0.100%	0.474%
2/8/2006	32.50	1.3%	1.34	0.100%	0.472%
2/7/2006	32.07	-1.4%	(1.35)	0.100%	0.470%
2/6/2006	32.51	-0.3%	(0.31)	0.100%	0.467%
⋮	⋮	⋮	⋮	⋮	⋮



Risk Measurement

Market Risk - Diversification

- We make no assumptions concerning diversification – We let the data do the talking

Position ($MM)		GE Stock 30 (MTM)	10Yr Treasury Bond 100 (Notional)	Total	Simple Sum	Diversification
Market Risk	**Unweighted**	**0.74**	**0.76**	**0.91**	**1.50**	**39%**
(95% VaR in $MM)	**Weighted**	**0.40**	**0.62**	**0.80**	**1.02**	**22%**
	Date	**Simulated P&L ($MM)**				
	2/28/2006	-0.41	0.38	-0.03		
	2/27/2006	0.16	-0.22	-0.05		
	2/24/2006	-0.11	-0.06	-0.17		
	2/23/2006	-0.12	-0.32	-0.44		
	2/22/2006	0.25	0.26	0.52		
	2/21/2006	-0.22	-0.20	-0.42		
	2/17/2006	0.24	0.48	0.71		
	2/16/2006	-0.10	0.06	-0.04		
	2/15/2006	0.00	0.06	0.06		
	2/14/2006	0.19	-0.21	-0.02		
	.	.	.	.		
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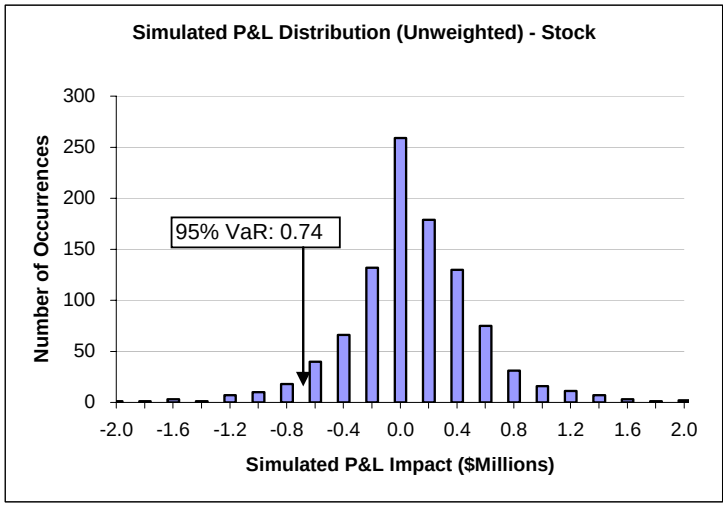
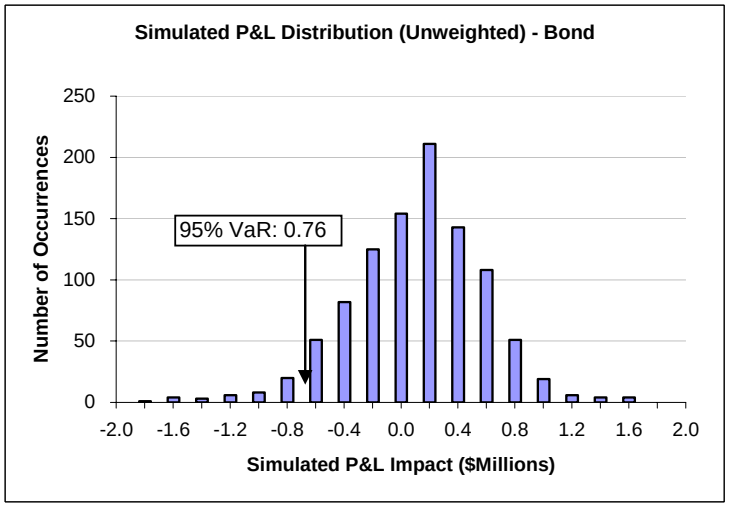
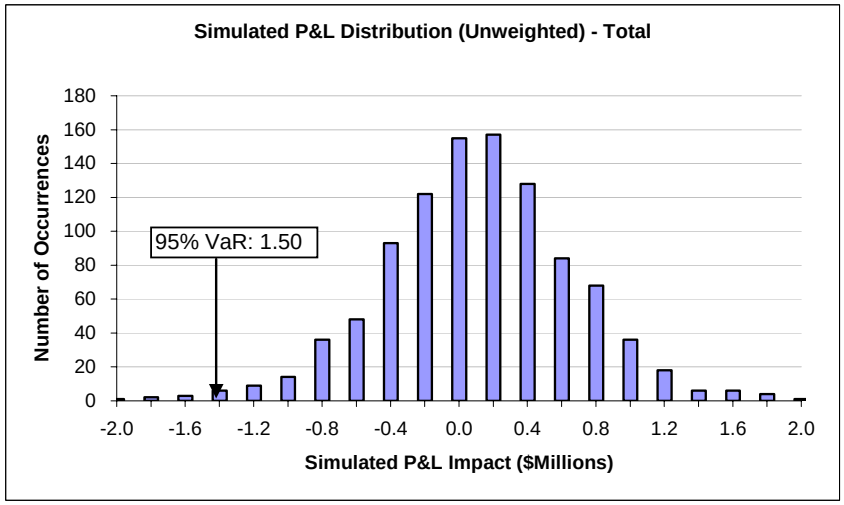
	.	.	.	.		
	3/19/2002	35.91	0.00	0.00		
	3/18/2002	35.91	-0.01	-0.22		
	3/15/2002	36.17	-0.01	-0.16		
	3/14/2002	36.37	0.01	0.31		
	3/13/2002	36.00	-0.03	-0.80		
	3/12/2002	36.99	0.00	-0.03		
	3/11/2002	37.03	0.01	0.40		

Risk Measurement

Market Risk - Diversification







Risk Measurement

Market Risk

- Linear risk is measured by calculating the sensitivities of all products to the relevant risk factors – the level, shape and slope of the yield curve, credit spreads, basis, foreign exchange, equity price changes etc. – and then simulating a walk-back through time to determine the P&L impact of changes in these relevant risk factors on today's portfolio

- **Simulation of Linear Risk: Conceptual Framework**

$$[\text{Historical Time Series}] \times [\text{Sensitivity Vector}] = [\text{Simulated P \& L}]$$

$$\begin{array}{cccc} \underline{\text{O/N}} & \underline{\text{1Yr}} & \cdots & \underline{\text{30Yr}} \end{array}$$

$$\begin{bmatrix} D_1 & D_1 & \cdots & D_1 \\ D_2 & D_2 & \cdots & D_2 \\ & & \cdots & \\ \vdots & \vdots & & \vdots \\ D_N & D_N & \cdots & D_N \end{bmatrix} \times \begin{bmatrix} S_{O/N} \\ S_{1Yr} \\ \vdots \\ S_{30Yr} \end{bmatrix} = \begin{bmatrix} P_1 \\ P_2 \\ \vdots \\ P_N \end{bmatrix}$$

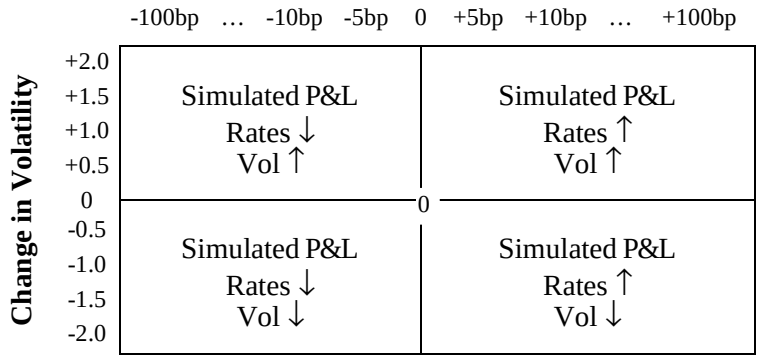
Risk Measurement

Market Risk

We employ a comparable approach to assessing the nonlinear risks created by the optionality in the portfolio, which we combine with the linear component described above.

Simulation of NonLinear Risk: Conceptual Framework

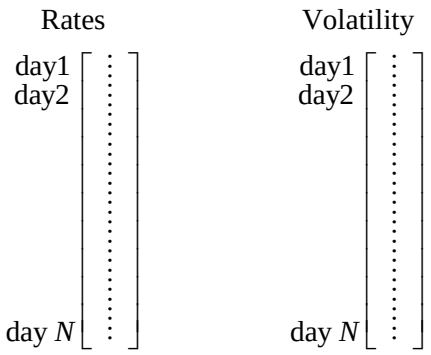
Change in Underlying Benchmark Interest Rate



Step 1:

Revalue portfolio for changes in rates and volatility. Each observation in the table represents the change in the portfolio P&L due to a simultaneous change in the benchmark interest rate and implied volatility.

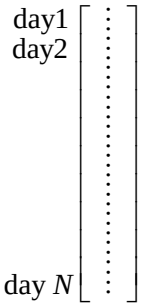
Historical Time Series



Step 2:

Taking a time series of actual simultaneous changes in rates and implied vol over the past four years and, using the matrix as a look-up table, we create a simulated P&L vector.

Simulated P&L



Step 3:

Vector of simulated P&Ls from Step 2.

Risk Measurement

Market Risk

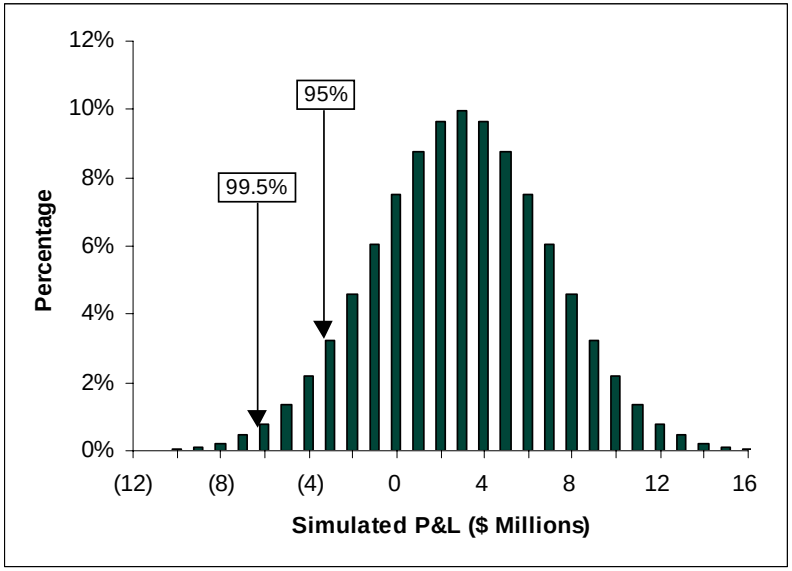
Market risk is then determined by taking all of the simulated P&L vectors, representing both linear and nonlinear exposure, and adding the P&Ls across each day over the past four years. We then use this one, combined P&L vector to create a histogram from which we cut a tail at any given level of confidence. This approach – simulating a "walkback" through history to determine a simulated P&L distribution for today's portfolio – is the underpinning of our framework for market risk.

Combining Linear and NonLinear Risk

$$\begin{bmatrix}\text{Linear}\\ \text{Simulated}\\ \text{P \& L}\end{bmatrix} + \begin{bmatrix}\text{Non - Linear}\\ \text{Simulated}\\ \text{P \& L}\end{bmatrix} = \begin{bmatrix}\text{Total}\\ \text{Simulated}\\ \text{P \& L}\end{bmatrix}$$

$$\begin{matrix}\text{day 1}\\ \text{day 2}\\ \\ \\ \\ \\ \text{day N}\end{matrix}\begin{bmatrix}\cdot\\ \cdot\\ \vdots\\ \\ \\ \vdots\\ \cdot\end{bmatrix} + \begin{matrix}\text{day 1}\\ \text{day 2}\\ \\ \\ \\ \\ \text{day N}\end{matrix}\begin{bmatrix}\cdot\\ \cdot\\ \vdots\\ \\ \\ \vdots\\ \cdot\end{bmatrix} = \begin{matrix}\text{day 1}\\ \text{day 2}\\ \\ \\ \\ \\ \text{day N}\end{matrix}\begin{bmatrix}\cdot\\ \cdot\\ \vdots\\ \\ \\ \vdots\\ \cdot\end{bmatrix}$$

Histogram of Simulated P&Ls



Risk Measurement

Event Risk

- In addition to measuring market risk we also measure event risk
- These are potential losses which go beyond the mark-to-market losses and are associated with:
  - Downgrades for high grade loans, bonds, and convertibles
  - Defaults for high yield loans, bonds, and convertibles
  - Defaults for sub-prime mortgage loans
  - Property value losses on real estate
  - Dividend yield assumptions for equity derivatives
  - Gap risk for fund derivatives

Risk Measurement

Event Risk

High Yield Event Risk – Conceptual Framework

Bond	"ABC"	"XYZ"	"KLM"
Rating	Ba	B	Baa
Default Probability	1.23%	6.80%	0.14%
No Default Probability	98.77%	93.20%	99.86%
Position Market Value ($mm)	25.0	15.0	30.0
Exposure after 30% Recovery ($mm)	17.5	10.5	21.0

Establish Every Possible Outcome with Joint Probability

Possible Combinations ($2^3 = 8$)	Loss Table			Number of Bonds Default	Portfolio Exposure ($mm)	Joint Probability
1	17.5	10.5	21.0	3	49.0	0.00012%
2	17.5	10.5	–	2	28.0	0.08352%
3	17.5	–	21.0	2	38.5	0.00160%
4	–	10.5	21.0	2	31.5	0.00940%
5	17.5	–	–	1	17.5	1.14476%
6	–	10.5	–	1	10.5	6.70696%
7	–	–	21.0	1	21.0	0.12888%
8	–	–	–	0	0.0	91.92476%

Risk Measurement

Event Risk

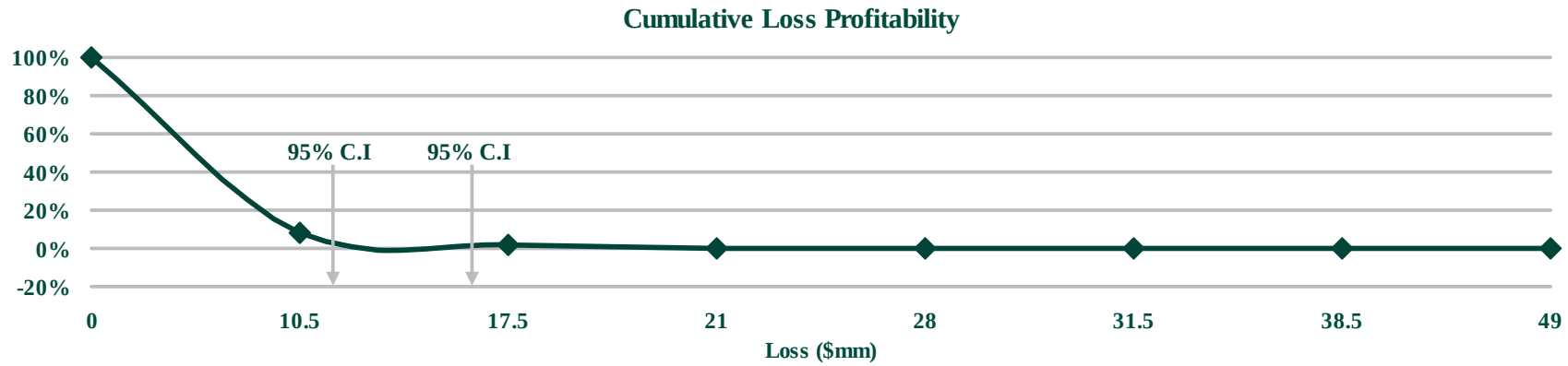
High Yield Event Risk (Cont'd)

- We then rank total exposures along with their joint probability of occurrence in descending order and create a cumulative distribution from which we cut a tail at 95% and 99.5% confidence intervals

Portfolio Exposure ($mm)	Joint Profitability	Cumulative Probability of Loss Greater than or Equal to Portfolio Exposure Amount
49.0	0.00012%	0.00012%
38.5	0.00160%	0.00172%
31.5	0.00940%	0.01112%
28.0	0.08352%	0.09465%
21.0	0.12888%	0.22352%
17.5	1.14476%	1.36828%
10.5	6.70696%	8.07524%
0.0	91.92476%	100.00000%

99.5% CI: 20.2

95% CI: 13.7



Risk Measurement

Real Estate Event Risk: Conceptual Framework

Step 1: Revalue each property to simulate P&L impact (6 possible property types with 55 MSAs)

$$\begin{bmatrix}\text{Market Value}\\ \text{of Property}\end{bmatrix} \times \begin{bmatrix}\text{Historical Time Series of}\\ \text{Property Value Changes}\end{bmatrix} - \begin{bmatrix}\text{Senior Debt}\\ \text{if applicable}\end{bmatrix} - \begin{bmatrix}\text{Lehman Loan}\\ \text{MTM Basis}\end{bmatrix} = [\text{ Simulated P\&L for each loan }]$$

Example 1: Lehman holds the first lien

Property value = $100 million, 80% LTV loan marked at 90% so our "basis" is $72 million[1]

- if the property value goes below $72 million, we show a dollar-for-dollar loss below $72 million
- if the property value goes to $90 million, we have no loss and a "pull-to-par" of $8 million

$$\begin{pmatrix}\text{property value is \$90mm}\\ \text{loan is 80\$mm - sufficient amount to pay the loan in full}\\ \text{basis is \$72mm}\\ \text{"pull to par"} = \$80 - \$72 = \$8\text{mm}\end{pmatrix}$$

1. *Origination fees and positive carry applied to reduce basis.*

Risk Measurement

Real Estate Event Risk

Example 2: Lehman holds the second lien

Property value = $100 million, 1st mortgage (with a 3rd party) is $60 million, Lehman holds the mezz of $25 million with a basis of $22 million

- If the property value goes to $90 million, we show no loss and a "pull-to-par" of $3 million

  property value is $90mm
  1st lien is $60mm which is covered leaving $30mm
  mezz is $25mm
  basis is $22mm
  "pull to Par" = $25mm - $22mm = $3mm

- If the property value goes to $80 million, we have a loss of $2 million

  property value is $80mm
  1st lien is $60mm which is covered leaving $20mm
  mezz is $25mm
  basis is $22mm
  loss = $20mm - $22mm = $2mm

Risk Measurement

Real Estate Event Risk

Step 2: We then take the simulated P&Ls and aggregate losses across property types within MSAs. By doing this we take the conservative assumption of perfect correlation across the property types. The simulated P&L for a specific time period will include pull-to-par and exit fees only when property values survive a decline still allowing for sufficient coverage of Lehman's basis; otherwise pull-to-par and exit fees are zero. This process results in up to 55 simulated P&L vectors, with 62 observations in each MSA (4 quarters annually for 15.5 years)

New York Simulated P&L

$$\begin{bmatrix} P\&L_1 \\ P\&L_2 \\ \vdots \\ \vdots \\ P\&L_{62} \end{bmatrix}$$

Chicago Simulated P&L

$$\begin{bmatrix} P\&L_1 \\ P\&L_2 \\ \vdots \\ \vdots \\ P\&L_{62} \end{bmatrix}$$

Boston Simulated P&L

$$\begin{bmatrix} P\&L_1 \\ P\&L_2 \\ \vdots \\ \vdots \\ P\&L_{62} \end{bmatrix}$$

Step 3: Lastly, we aggregate across MSAs using the same approach as described above where we take the total exposures and calculate joint probabilities; a cumulative probability distribution is then created from which we cut a tail at any confidence interval to determine the Event Risk

Risk Measurement

Counterparty Credit Risk

- Counterparty credit risk measures the potential loss to the Firm due to non-performance of our counterparties on forward settlements, financing and OTC derivatives transactions
- The measurement is a three-step process:
  - Measure the Exposure-At-Default (EAD) to each counterparty
    - We calculate the Maximum Potential Exposure (MPE) profile at 95% confidence level over the life of the portfolio of trades with each counterparty
    - For general counterparties, EAD is the average of current exposure and peak-over-life MPE
    - For hedge funds and emerging market counterparties, EAD is the peak-over-life MPE.
  - Assign a 1-year Probability of Default (PD) and Loss Given Default (LGD) to each counterparty:
    - We map our internal rating scale to external rating scales.
    - The PD is obtained from historical cumulative default curves produced by the rating agencies. To be conservative, we calculate the 1-year PD from the cumulative 3-year PD.
    - LGDs are industry-specific and based on estimates provided by rating agencies.
  - Calculate the tail loss of the portfolio:
    - We assume that default events are independent across counterparties.
    - We calculate the portfolio loss distribution based on the portfolio of default events characterized by PDs, LGDs and EADs to each counterparty.
    - We pick the 95 percentile loss as the counterparty risk for Risk Appetite.
    - We pick the 99.5 percentile loss as the counterparty risk for Risk Equity.

Risk Measurement

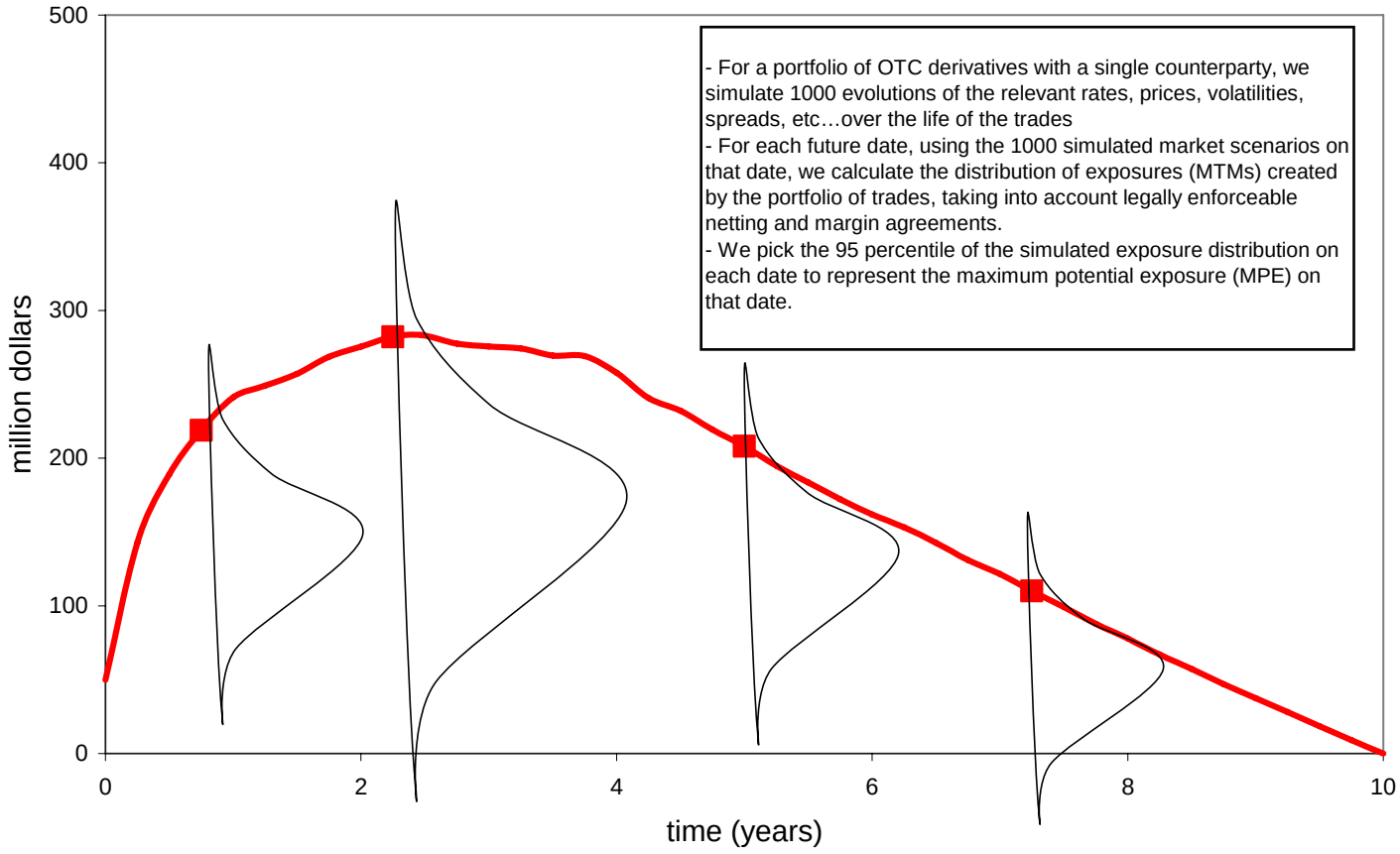
Counterparty Credit Risk

- **Maximum Potential Exposure (MPE)**
  - The MPE models use various simulation techniques to assess the potential future exposures of the Firm to its counterparties
  - The models recognize legally enforceable netting rights as well as initial and variation margin terms of collateral agreements
- **Current Credit Exposure (CCE)** – With respect to an individual client portfolio or an aggregate of client portfolios, CCE represents the maximum credit loss amount (zero recovery) after accounting for legally enforceable netting rights and collateral held or posted.
  - The Firm computes CCE at a counterparty level by aggregating the current valuation of all transactions in the counterparty's portfolio and subtracting / adding any collateral held / posted adhering to legally enforceable netting provisions.
  - Netting provisions, if applicable, allow the netting of positive and negative values, typically resulting in reduced exposure. In the absence of netting, the current exposure comprises the sum of only positive marks. Credit exposure, either current or potential, is defined to be either zero or positive at the counterparty level and throughout the parent hierarchy.
  - CCEs are calculated daily and stored in the Credit Workstation System (CWS)

Risk Measurement

Counterparty Credit Risk - MPE Calculation

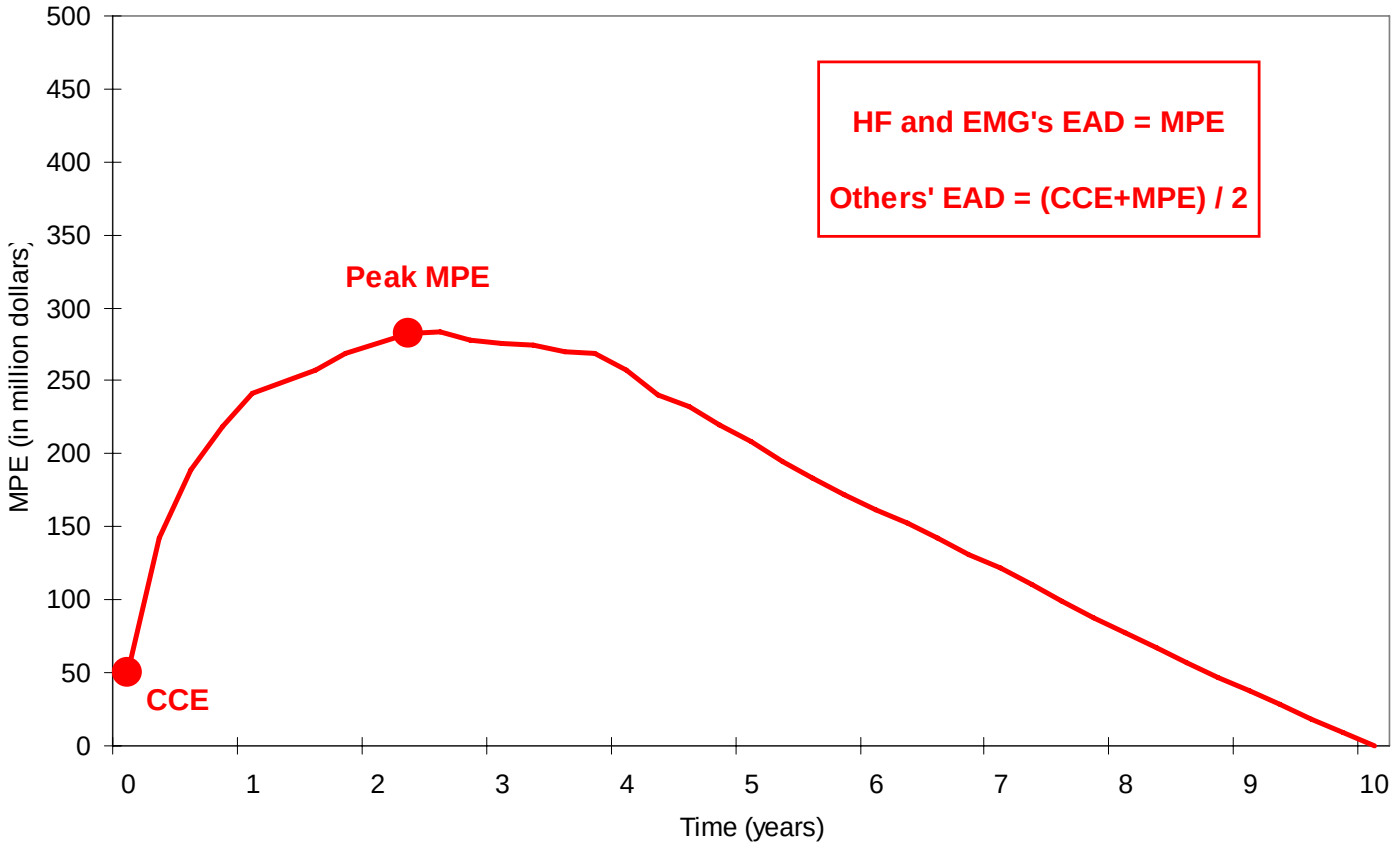
The MPE Profile is the Graph of the 95 percentile of the Probability Distribution of Credit Exposures Created by the Portfolio of Trades with the Counterparty



Risk Measurement

Counterparty Credit Risk - MPE Approximation

The MPE profile of each counterparty is summarized by the average MPE over each year



Risk Measurement

Risk Aggregation - Market Risk

- **Diversification and Correlation: Conceptual Framework** – We allow for the benefit of diversification in aggregating risk across businesses while recognizing correlations exist across risk categories within businesses

Diversification

Within Market Risk across businesses and divisions

- Diversification benefits arise from businesses functioning as part of a larger unit
  - Trading Desks – Regional Businesses
  - Regional Businesses – Global Businesses
  - Global Businesses – Divisions
  - Divisions – Firm

Correlation

Within businesses across the risk categories

- Correlation exists
  - Market risk
  - Event risk
  - Counterparty Credit risk

Risk Measurement

Risk Aggregation - Market Risk

Diversification and Correlation – Conceptual Framework (Cont'd)

Regional Businesses => Global Businesses

Governments America Total Simulated P&L	+	**Governments Europe Total Simulated P&L**	+	**Governments Asia Total Simulated P&L**	=	**Total Governments Simulated P&L**
day 1 [·]		day 1 [·]		day 1 [·]		day 1 [·]
day 2 [·]		day 2 [·]		day 2 [·]		day 2 [·]
· [·]		· [·]		· [·]		· [·]
	+		+		=	
· [·]		· [·]		· [·]		· [·]
· [·]		· [·]		· [·]		· [·]
day N [·]		day N [·]		day N [·]		day N [·]
$MR_{AMERICA}$	+	MR_{EUROPE}	+	MR_{ASIA}	>	MR_{TOTAL}

- For each simulated P&L we cut a tail to get market risk as described above. Diversification exists because the sum of the market risk estimated from each simulated P&L distribution is greater than the sum of the market risk estimated from the combined total simulated P&L distribution. The difference is the diversification benefit

Risk Measurement

Risk Aggregation - Market Risk

Diversification and Correlation – Conceptual Framework (Cont'd)

Global businesses => Divisions

Total Governments Simulated P & L	+	Total Credit Products Simulated P & L	+	Total Foreign Exchange Simulated P & L	+…+	=	Total Fixed Income Simulated P & L
day 1 [·		day 1 [·		day 1 [·			day 1 [·
day 2 ·		day 2 ·		day 2 ·			day 2 ·
· ·		· ·		· ·			· ·
	+		+		+…+	=	
· ·		· ·		· ·			· ·
· ·		· ·		· ·			· ·
day N ·]		day N ·]		day N ·]			day N ·]
$MR_{GOVERNMENTS}$	+	$MR_{CREDIT\ PRODUCTS}$	+	$MR_{FOREIGN\ EXCHANGE}$	+…+	>	$MR_{FI\ DIVISION}$

Risk Measurement

Risk Aggregation - Market Risk

Diversification and Correlation – Conceptual Framework (Cont'd)

Divisions => Firm

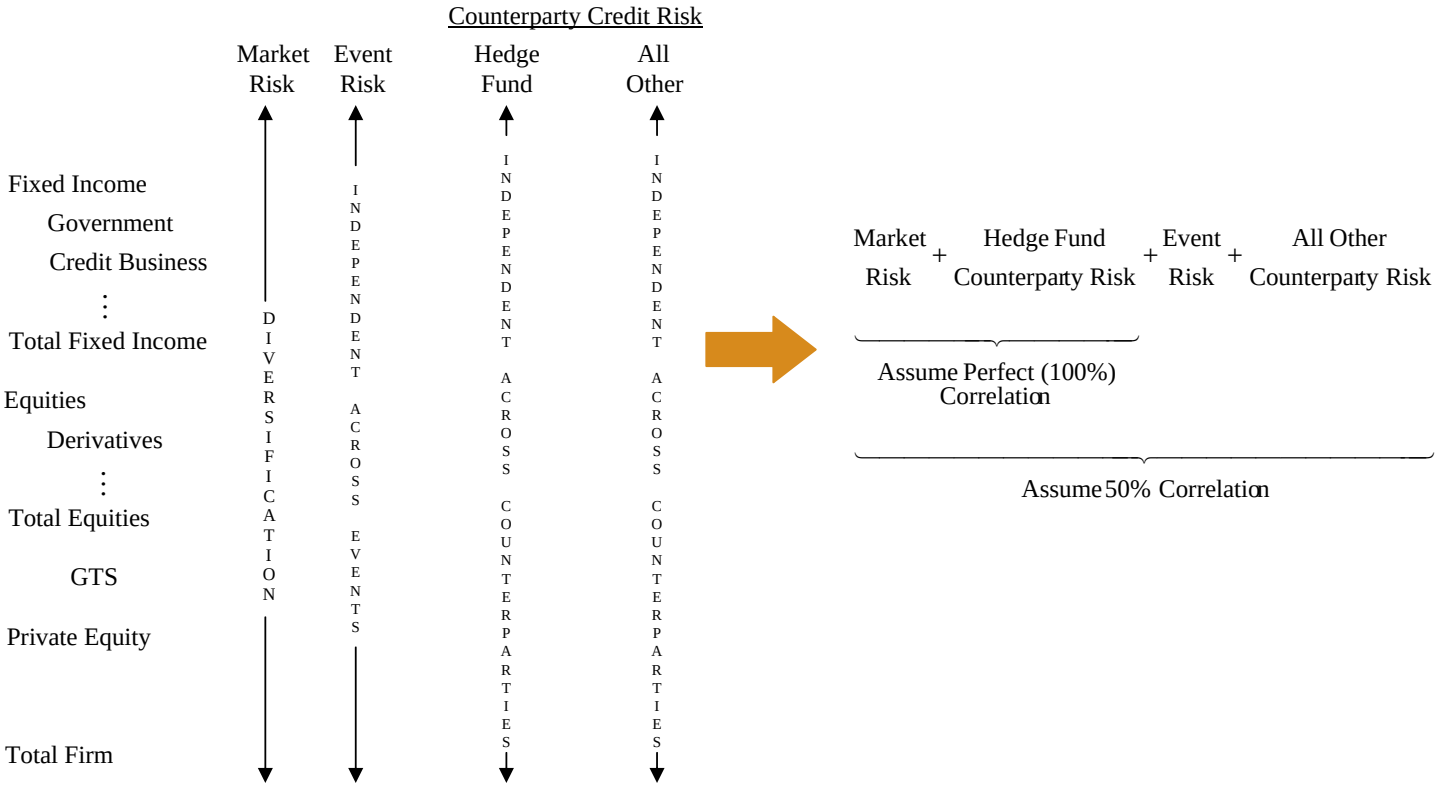
Fixed Income	+	Equities	+	GTS	+	Private Equity	=	Firm
day 1 ·		day 1 ·		day 1 ·		day 1 ·		day 1 ·
day 2 ·		day 2 ·		day 2 ·		day 2 ·		day 2 ·
· ·		· ·		· ·		· ·		· ·
	+		+		+		=	
· ·		· ·		· ·		· ·		· ·
· ·		· ·		· ·		· ·		· ·
day N ·		day N ·		day N ·		day N ·		day N ·

MR_{FI} + MR_{EQ} + MR_{GTS} + $MR_{Private\ Equity}$ > MR_{Firm}

Risk Measurement

Risk Aggregation - Event Risk, Counterparty Credit Risk, and Total Risk

- Event risk and counterparty credit risk is assumed to be independent across events and counterparties
- Within a business, market and Hedge Fund counterparty credit risk is assumed to be perfectly correlated while market risk is assumed to be 50 % correlated with event and all other counterparty credit risk



Stress Testing and Scenario Analysis

Risk Measurement Transcends Statistical Models

- Stress tests and scenario analyses are performed periodically to evaluate the potential P&L impact on a portfolio of plausible yet abnormal 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 do not allow for re-hedging or selling down a position either actively or through the automatic execution of existing stop losses
- Re-runs of historical episodes of extreme market moves are performed daily to evaluate the impact on the current portfolio of a repeat of these stressed time periods. For example:
  - 9/11 terrorist attacks
  - Russia default contagion and LTCM
  - November 2001 volatile bond market
  - October 1987 stock market crash
- Hypothetical scenarios are periodically used to evaluate the potential P&L impact on a portfolio 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 increase leading to cost-push inflation
  - yield curve steepening due to potential inflationary expectations
  - credit spreads widening due to an increase in the overall level of the curve

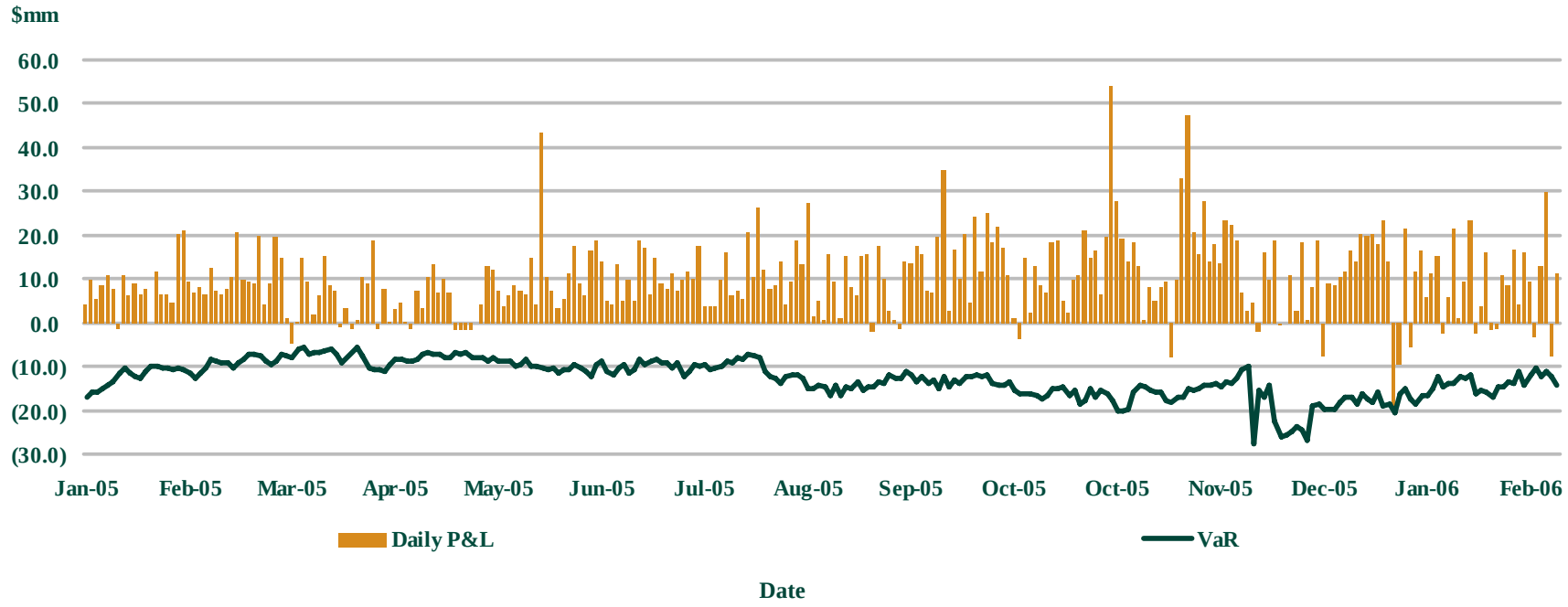
Model Validation

- Pricing and valuation models are developed by the quantitative research groups dedicated to each business. The models are implemented by analytics and technology groups. Risk Management is an integral part of the model development process from
  the outset
- Various aspects of models are independently validated by Risk Management
  - Theoretical framework
  - Calibration to reference instruments
  - Mathematical and software implementations
  - Testing of extremes and convergence to other previously validated models
  - Sensitivities of the model's prices to input parameters
  - Appropriate reserves for model risk
- Controllers verify the model input parameters and output prices on an on-going basis. Any abnormality is reported to business and Risk Management and may determine model upgrades or changes
- As mentioned earlier, the Firm has established Model Control Committees to monitor and direct the model control process on an ongoing basis, including the scheduling and prioritizing of model reviews, assessing the levels of model risk and valuation adjustments and ensuring that the model control process adheres to the agreed guidelines and satisfies best practice
- The Committees, which meet periodically, are chaired by the Business Unit and include as members the Head and senior members from Quantitative Research, Analytics, Risk Management, Product Control, and Technology. Other guests may be invited on specific model issues

Model Vetting and Back-testing

- Back-testing is performed to determine the reasonableness of the VaR measures by comparing the actual net trading profits and losses of a portfolio to the VaR generated for the portfolio. As an example, Equity division back-testing is below

Equity Division Daily P&L vs. VAR – February 2005–February 2006



Risk Limits

- The Firm operates under a comprehensive regime of limits for risk. In addition to Risk Appetite portfolio and VaR limits, we have limits for single transactions, counterparts and countries, as well as concentration limits for selected asset classes, industries and credit sectors
- The **Single Transaction Limit** framework limits the size of single transactions even if a transaction can be accommodated within the risk appetite 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 Risk Committee has the authority to approve transactions within these limits
  - Executive Committee approval is required in rare circumstances where transactions could exceed these limits
- **Counterparty Credit Limits** are set for each counterparty group and legal entity based on our internal risk ratings
  - Within this framework, limits by product and tenor are established for each legal entity within a group
  - Limits are set based on our potential risk exposure for a product
    - Money lines are established with the large banks for liquidity management
    - Exposures for traded products are measured primarily on an MPE (Maximum Potential Exposure) basis, taking into account netting and collateral where available
    - Settlement limits are set where we, due to market convention, have free delivery (FX)
  - Limits are reviewed annually or biannually in accordance with our credit policy while usage against the limits is monitored daily

Risk Limits

- While the Single Transaction Limit establishes a framework for limits on the size of an individual transaction we also place limits on groups of positions which have similar characteristics and therefore are correlated
  - **Concentration Limits** are set on
    - Asset classes
    - Industry sector
    - Credit sector
    - Underlying name
- **Country 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 Loss Potential basis
  - This process limits losses arising from a crisis in a country or a region
  - Encourages prudent risk taking

Accountability

Exception Process Description

- 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 adjustments or terminations
- The Chief Risk Officer has the authority to approve exceptions. The Global Heads of Market Risk and Credit Risk will make recommendations
- If the overall risk appetite limit were to be breached the Chief Risk Officer would immediately notify the Chief Administrative Officer and the Risk Committee

Market Risk

- Market risk limits are derived from the overall risk appetite limit which is recommended by the Chief Risk Officer and approved by the Executive Committee
- Limits are cascaded down to divisions, businesses and regions. Trading desk heads further allocate limits to individual desks
- Once established, Market Risk Management monitors the limits
- If a limit is breached the market risk manager discusses this with the traders involved, the Business Unit Manager / Desk head, the Head of Market Risk Management and the Chief Risk Officer. The Chief Risk Officer will then either
  - Allow the excess to remain for an agreed period of time in support of the specific trading strategy. This action may occur in cases where the excess was anticipated and discussed with Market Risk Management at an early stage, or where the excess is in support of a customer facilitation trade
  - Agree, in some circumstances, to revise the limit if, for example, there has been a change in the business which warrants such a change
  - Instruct the business to reduce the risk profile back within the limit

Accountability

Exception Process Description

Credit Risk

- Credit authorities for counterparty credit are delegated to credit officers. Authorities are based on Maximum Potential Exposure and are set by internal risk rating and tenor
- The Chief Risk Officer has unrestricted authority as delegated by the Executive Committee and determines the roles and responsibilities and the level of authority
- Six levels of authority are approved
- Credit analysts approve limits within delegated authority
- Except for pre-approved limits approval is required prior to each transaction
- Exposure and product limits are monitored on a daily basis – (Current Credit Exposure (CCE), notional limits, MPE)
- Any transactions in excess of limits require specific credit approval under delegated credit authority and is escalated in the same manner as discussed above

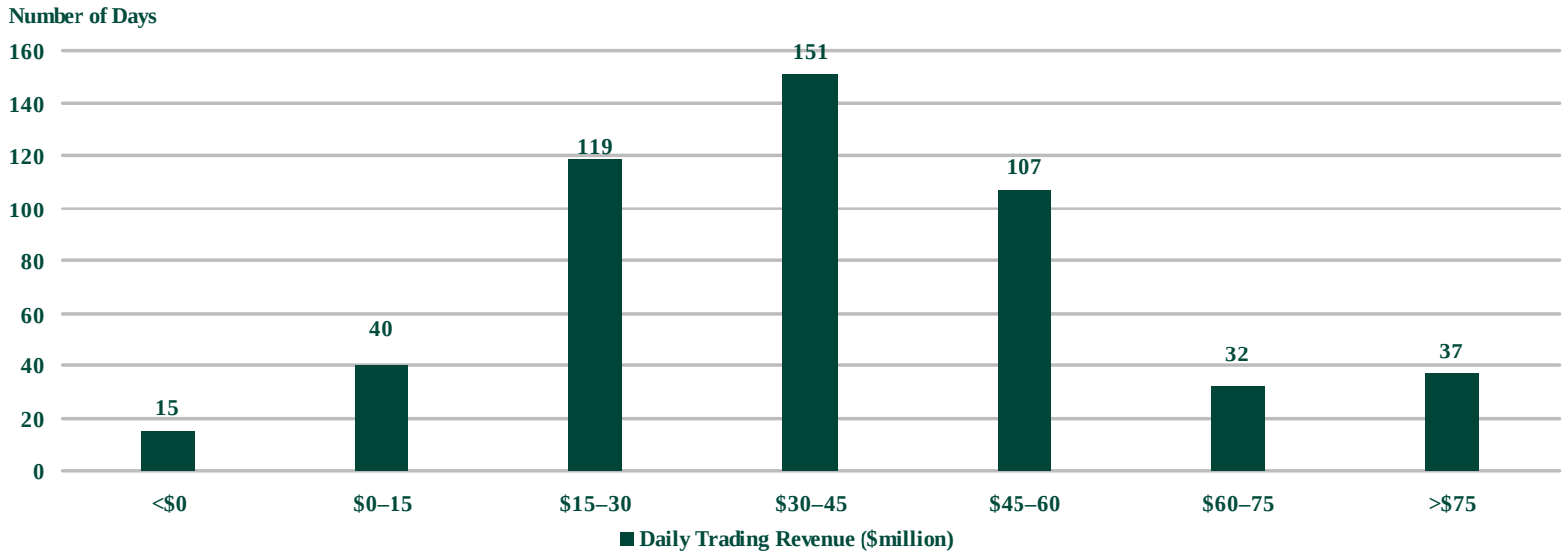
Review of Results

Review of Results

Trading Revenues

- In the two years from March 2004 through February 2006, we had fifteen(15) negative days. The largest loss was $26.9 million
- Over the same two-year period, we had a $40 million average daily trading revenue and thirty-seven(37) days with gains greater than $75 million. The bulk of the large gains were from sales of real estate positions which, under current accounting rules, have to be valued at the lower-of-cost-or-market. Because we are not on mark-to-market for these positions, appreciation is not recognized until we sell the property. However, impairments are recognized as they occur over time
- The significant mean and gains in our trading revenue distribution reflects our strong franchise

Daily Trading Revenue Distribution (March 2004 through February 2006)

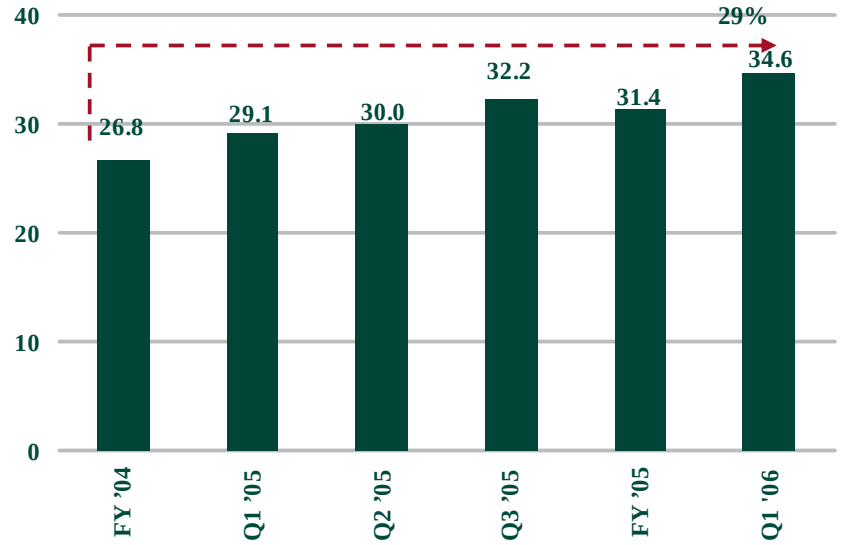


Review of Results

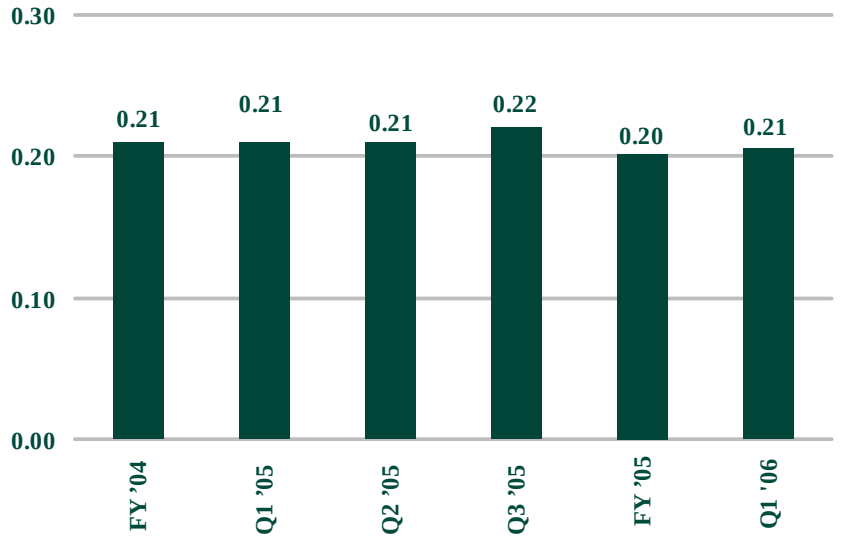
Value-at-Risk

- For all its limitation, VaR is a useful way of aggregating risk across the Firm and provides a useful view into the risk of the Firm
- As a percentage of tangible equity, empirical VaR has remained relatively constant

VaR ($million) – Empirical VaR



Empirical VaR as Percent of Tangible Equity*



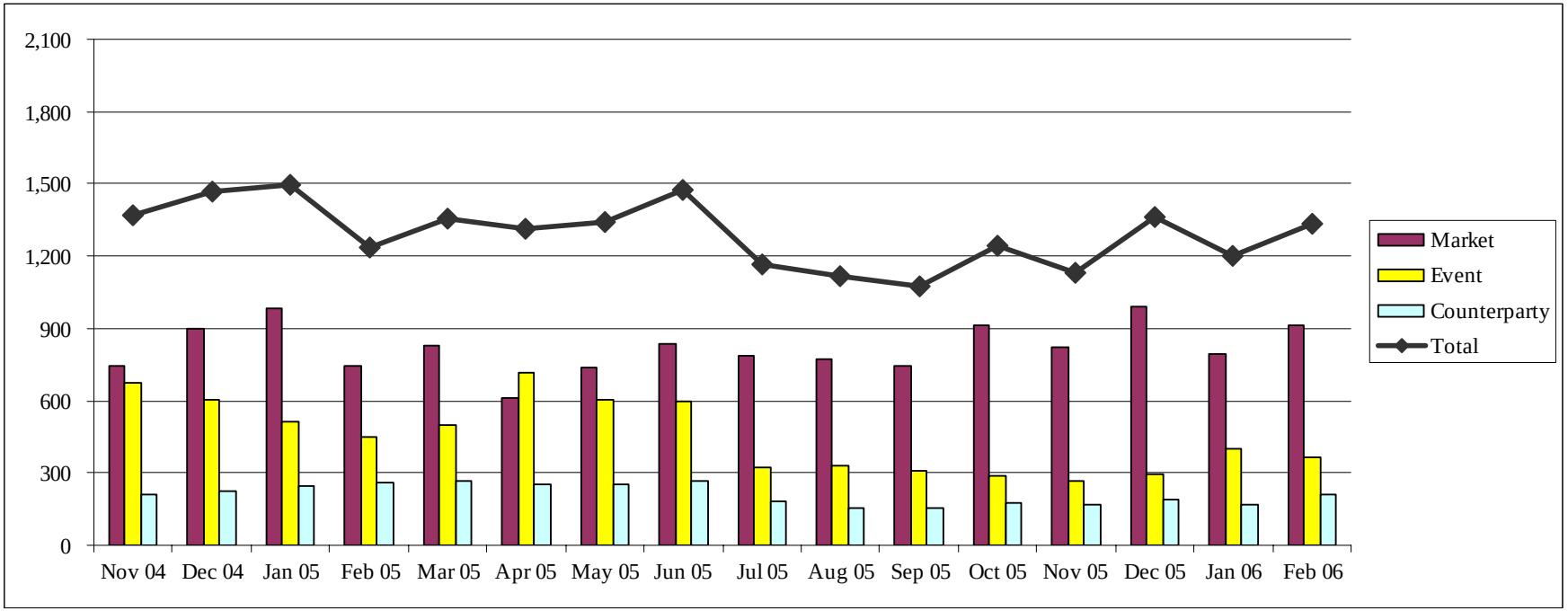
*As defined in 10-Q/K for leverage calculations.

Review of Results

Risk Appetite Usage

- The Firm's overall risk usage remains well within its risk appetite limit which is set annually, reviewed quarterly
- Risk appetite usage is calculated daily on a global, consolidated basis and measured against limits
- Our franchise is highly diversified due to our product and business mix as well as our international presence

Risk Usage – Total Firm ($ million)



Review of Results

Counterparty Credit Risk

- 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
- 97.8% of our counterparty exposure is in investment grade names

Credit Exposure Trend by Rating

(US$ million)

	Ratings						Percentages					
	4Q '04	**1Q '05**	**2Q '05**	**3Q '05**	**4Q '05**	**1Q '06**	**4Q '04**	**1Q '05**	**2Q '05**	**3Q '05**	**4Q '05**	**1Q '06**
AAA	3,500	3,985	3,759	3,745	3,569	4,347	20.4%	20.9%	21.1%	20.5%	19.3%	22.5%
AA	6,924	8,036	5,710	6,163	6,763	6,643	40.5%	42.0%	32.1%	33.7%	36.5%	34.3%
A	4,528	4,910	6,110	5,966	5,933	6,073	26.5%	25.7%	34.3%	32.6%	32.0%	31.5%
BBB	1,609	1,527	1,540	1,807	1,825	1,826	9.4%	8.0%	8.6%	9.9%	9.8%	9.5%
BB	428	540	564	467	314	336	2.5%	2.8%	3.2%	2.5%	1.7%	1.8%
B or Lower	124	114	130	156	135	83	0.7%	0.6%	0.7%	0.8%	0.7%	0.4%
Total	**17,113**	**19,112**	**17,813**	**18,304**	**18,539**	**19,308**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

	4Q '04	**1Q '05**	**2Q '05**	**3Q '05**	**4Q '05**	**1Q '06**
Investment Grade	96.8%	96.6%	96.1%	96.6%	97.6%	97.8%
Below Investment Grade	3.2%	3.4%	3.9%	3.4%	2.4%	2.2%
	100.0%	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Note: Does not include money market deposits.

Review of Results

Counterparty Credit Risk

- The bulk of our exposure is to banks and other financial institutions
- Hedge Fund exposure represents less than 1% of our total portfolio

Current Credit Exposure Trend by Sector

(US$ million)	Sector						Percentages					
	4Q '04	**1Q '05**	**2Q '05**	**3Q '05**	**4Q '05**	**1Q '06**	**4Q '04**	**1Q'05**	**2Q '05**	**3Q '05**	**4Q '05**	**1Q '06**
Banks	7,576	9,355	7,779	7,665	8,724	7,773	44.3%	49.0%	43.6%	41.9%	47.1%	40.2%
Other Financial	3,926	3,504	3,273	3,552	3,401	4,127	22.9%	18.3%	18.4%	19.4%	18.3%	21.4%
Municipal Issuer	1,671	1,868	2,176	2,313	1,946	1,809	9.8%	9.8%	12.2%	12.6%	10.5%	9.4%
Insurance	794	881	1,017	966	1,210	1,325	4.6%	4.6%	5.7%	5.3%	6.5%	6.8%
Government Entity	933	1,096	1,067	1,409	912	1,559	5.5%	5.7%	6.0%	7.7%	4.9%	8.1%
Broker / Dealer	1,080	941	901	906	898	924	6.3%	4.9%	5.1%	5.0%	4.8%	4.8%
Industrial Services	825	1,060	970	895	857	770	4.8%	5.6%	5.4%	4.9%	4.6%	4.0%
Pension Retirement Fund	233	299	441	399	418	860	1.4%	1.6%	2.5%	2.2%	2.3%	4.4%
Hedge Fund	75	102	160	185	145	152	0.4%	0.5%	0.9%	1.0%	0.8%	0.8%
High Net Worth Individuals	0	8	29	14	28	9	0.0%	0.0%	0.2%	0.1%	0.2%	0.1%
Total	**17,113**	**19,112**	**17,813**	**18,304**	**18,539**	**19,308**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Note: Does not include money market deposits.

Review of Results

Counterparty Credit Risk

- 90.3% of our exposure is in the U.S., Canada and western Europe

Current Credit Exposure Trend by Region

(US$ million)	Region (Based on Legal Country)						Percentages					
	4Q '04	**1Q '05**	**2Q '05**	**3Q '05**	**4Q '05**	**1Q '06**	**4Q '04**	**1Q '05**	**2Q '05**	**3Q '05**	**4Q '05**	**1Q '06**
Western Europe Region	8,551	8,663	8,364	8,596	8,590	10,017	50.0%	45.3%	47.0%	46.9%	46.3%	51.9%
U.S. / Canada	7,381	9,258	7,952	7,700	8,175	7,418	43.1%	48.4%	44.7%	42.1%	44.1%	38.4%
Japan	402	400	504	618	544	586	2.3%	2.1%	2.8%	3.4%	2.9%	3.1%
Latin America Region	336	327	470	684	755	680	2.0%	1.7%	2.6%	3.7%	4.1%	3.5%
Mid-East / Africa Region	66	79	94	72	96	80	0.4%	0.4%	0.5%	0.4%	0.5%	0.4%
Central and Eastern Europe Central Asia	19	31	38	111	22	38	0.1%	0.2%	0.2%	0.6%	0.1%	0.2%
Non-Japan Asia Region	358	354	391	523	357	489	2.1%	1.9%	2.2%	2.9%	2.0%	2.5%
Total	**17,113**	**19,112**	**17,813**	**18,304**	**18,539**	**19,308**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Note: Does not include money market deposits.

Review of Results

Counterparty Credit Risk

- In absolute terms, our counterparty credit exposure has been stable even though we have seen growth in our franchise

Current Credit Exposure Trend by Product

(US$ millions)	Product Group						Percentages					
	4Q'04	**1Q'05**	**2Q'05**	**3Q'05**	**4Q'05**	**1Q'06**	**4Q'04**	**1Q'05**	**2Q'05**	**3Q'05**	**4Q'05**	**1Q'06**
FID / CDS	7,150	7,722	8,119	8,825	7,887	7,813	41.8%	40.4%	45.6%	48.2%	42.5%	40.5%
Equity Finance	5,151	5,879	4,936	4,490	4,892	5,108	30.1%	30.8%	27.7%	24.5%	26.4%	26.5%
FI Financing	2,681	3,304	2,651	3,175	3,509	4,539	15.7%	17.3%	14.9%	17.4%	18.9%	23.5%
Foreign Exchange / Commodities	1,428	1,080	1,115	703	974	683	8.3%	5.6%	6.2%	3.8%	5.3%	3.5%
Equity Derivatives	501	610	708	761	879	919	2.9%	3.2%	4.0%	4.2%	4.8%	4.7%
Other (Forwards, Bond Options)	202	517	284	350	398	246	1.2%	2.7%	1.6%	1.9%	2.1%	1.3%
Total	**17,113**	**19,112**	**17,813**	**18,304**	**18,539**	**19,308**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Note: Does not include money market deposits.

Review of Results

Top 10 Counterparty Exposures

- The majority of our top counterparty exposures are to "A" and above credits. These exposures are mostly due to stock borrow or repo transactions
- Exposure to non-investment grade counterparties has been maintained at essentially the same very low level over the past several years

Top 10 Exposures (Excluding Money Market Deposits)

($ millions)

Counterparty	1Q'06
JPMorgan Chase Bank	647.7
Stichting Pensioenfonds Voor De Gezondheid (PGGM)	545.5
Bank of New York	476.9
Ministry of Finance Italy	449.2
Barclays Global Investors	419.3
UBS AG	412.1
State Street Bank & Trust Co.	361.4
Central Bank of Norway	336.0
Mellon Bank	320.7
Aegon Nederland NV	277.7
Total	**4,246.5**

Top 10 Non-Investment Grade Exposures

($ millions)

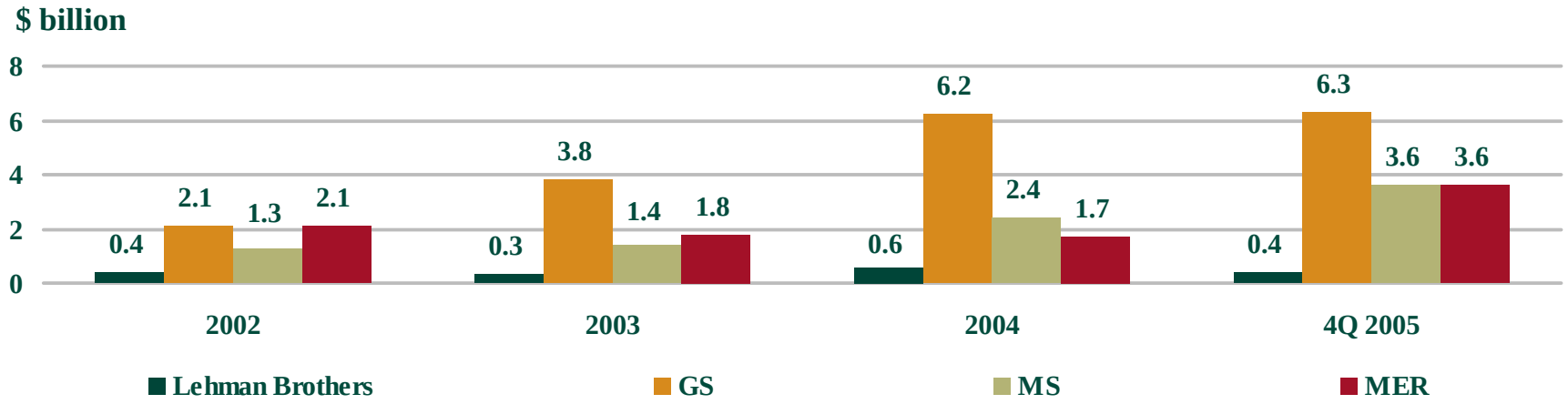
Counterparty	1Q'06
Lehman Brothers Real Estate Partners	31.6
Banco Central Do Brasil	23.7
E*trade Clearing LLC	19.4
Racer 2003-12-L	15.1
Eskaton Properties Inc	11.9
Retirement Housing Foundation	11.6
Capula Global Relative Value Master Fund	10.1
Guam Power Authority	9.6
Extendicare Health Services Inc	9.2
Asbury Methodist Village Inc	9.0
Total	**151.2**

Review of Results

Non-Investment Grade Derivatives Exposure

- Lehman Brothers has continually had the lowest non-investment grade derivative exposure in absolute terms and as a percentage of tangible equity as it relates to peers

Non-Investment Grade Derivative Exposures



Non-Investment Grade Derivative Exp as % Total Tangible Equity

	2002	2003	2004	4Q 2005
Lehman Brothers	4%	3%	5%	3%
GS	15%	23%	28%	25%
MS	6%	5%	8%	12%
MER	10%	7%	6%	11%

Conclusion

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