From: Corsalini, Enrico [enrico.corsalini@lehman.com]. Sent:6/26/2008 8:01 PM.
To: Tonucci, Paolo [paolo.tonucci@lehman.com]; Pellerani, Carlo [carlo.pellerani@lehman.com]; Thatcher, Kevin [kevin.thatcher@lehman.com]; Ito, Gregory [gito@lehman.com].
Cc: Sayani, Faizal [faizal.sayani@lehman.com].
Bcc: .
Subject: RE: Rating Agency Hybrid Limits.

Leverage is clearly an incomplete measure - but as the business models
and risk taking of the Inv. Banks are roughly similar, it is a
reasonable benchmark for capital sufficiency. Obviously misses asset
makeup / derivs / counterparty / etc....

Not sure about you - but if I am assessing the risk of an institution,
or a hedge fund - the first thing I ask is 'what is the leverage'.
Then (in uncertain order) leverage through derivs, asset makeup, off BS
exposure (hybrid of leverage), maybe throw in VAR, etc....
If somebody told me not to look at leverage but look at a model based
assessment - I would probably come back and ask about the leverage.
Then I would do my own assessment of sufficiency vs. assets..
But I may be too simple

enrico

-----Original Message-----
From: Tonucci, Paolo
Sent: Thursday, June 26, 2008 7:11 PM
To: Pellerani, Carlo; Corsalini, Enrico; Thatcher, Kevin; Ito, Gregory
Cc: Sayani, Faizal
Subject: Re: Rating Agency Hybrid Limits

Leverage is still a bad measure of refinancing or other risk. It may
well be introduced as a cap by regulators but effort should be to move
to better measures of refinancing and capital sufficiency.

The agencies would concede this but populist discuss around leverage is
unavoidable for anyone.

----- Original Message -----
From: Pellerani, Carlo
To: Corsalini, Enrico; Thatcher, Kevin; Ito, Gregory
Cc: Sayani, Faizal; Tonucci, Paolo
Sent: Thu Jun 26 02:42:37 2008
Subject: RE: Rating Agency Hybrid Limits

Enrico raises a good point. In my view, the meta question here is why do
we care about leverage:
A) If we only care about leverage because it is a limit imposed by CSE
then using CSE ratios is the right approach.
B) If we care about it because it is important for rating agencies and
hence rating then the most restrictive of the rating agencies becomes
our constraint
C) If we care about it because we think it is a valid way of managing
the Firm then we can use our judgement, market feedback and the
knowledge coming from rating agencies and CSE to devise our own
methodology.

As always, reality is a combination of the three above. The way we are managing leverage now is basically C) and to determine whether this need changes the key questions are HOW MUCH do rating agencies care about it and is the market telling us we need to change this? In the past we have been moving rating agencies away from leverage, what have recent discussions been?

Thx

From: Corsalini, Enrico
Sent: 26 June 2008 02:59
To: Thatcher, Kevin; Pellerani, Carlo; Ito, Gregory
Cc: Sayani, Faizal; Tonucci, Paolo
Subject: RE: Rating Agency Hybrid Limits

Kevin

Thank you for this very useful analysis. As a practical matter, I feel the firm should measure itself in-line with S&P. The loss absorption point as a going concern is real and a firm's ability to operate clearly places reliance on the true equity vs. hybrids...therefore reasonable limits make sense.
I understand the point on CSE, and it is an interesting data point but it doesn't seem like our internal measurements will drive our ratings.

I also feel there is a subtlety that could work against us if we insist on a leverage perspective different from S&P. If we feel that we are operating a business model with a net leverage of 10x, while S&P considers it 12x, then all else being equal S&P could look at us as conceding to their points that our business model requires less leverage (we say we are at 10x), but not getting there in S&Ps framework (12x).

This is probably a confusing point for the reader....

From: Thatcher, Kevin
Sent: Thursday, June 26, 2008 5:24 AM
To: Pellerani, Carlo; Corsalini, Enrico; Ito, Gregory
Cc: Sayani, Faizal
Subject: FW: Rating Agency Hybrid Limits

FYI

Faizal and I have not heard anything from you guys re. this analysis.
Let us know if you have any thoughts, comments and/or questions.

Kevin

From: Thatcher, Kevin
Sent: Tuesday, June 24, 2008 5:05 PM
To: Lowitt, Ian T
Cc: Tonucci, Paolo; Sayani, Faizal
Subject: Rating Agency Hybrid Limits

Ian,

Here is an updated version of the rating agency hybrid analysis that we sent to you on Friday. Key points are:

1) Based on rating agency formulas for hybrid exclusion, Lehman received

the following amounts of equity credit for the $2.0 bn mandatory convertible: S&P: $2.0 bn (100%) Moody's: $1.3 bn (67%) Fitch: $1.7 bn (86%).

2) Based on S&P's formula, our capital raise actually REDUCED the amount of hybrids excluded from equity consideration (i.e., it raised Lehman's Adjusted Total Equity as defined by S&P by more than $6 bn)

3) Even after adjusting for hybrid exclusions, Lehman still has the lowest net leverage among broker dealers according to S&P and Moody's and the second lowest according to Fitch.

4) Merrill Lynch has some serious hybrid capital issues and as a result has very high leverage, particularly when calculated with Moody's and Fitch's methodologies.

Please let us know if you have any questions. Also let us know how you would like to proceed with the analysis that we did comparing Lehman's illiquid assets to those of other broker dealers.

Regards,

Kevin

<< File: RA Hybrid Limits v.2.ppt >>

From: Sayani, Faizal
Sent: Friday, June 20, 2008 5:43 PM
To: Lowitt, Ian T; Tonucci, Paolo; Pellerani, Carlo
Cc: Ito, Gregory; Financial Planning and Analysis New York; Azerad, Robert; Corsalini, Enrico
Subject: Rating Agency Hybrid Limits

All-

We have received a number of inquiries in regards to Lehman's rating agency hybrid capacity. Please find the attached presentation that details where the Firm stands using each agencies methodologies. We have also applied the agencies methodologies to peers for comparative purposes.
<< File: RA Hybrid Limits v.1.ppt >>
Feel free to given Kevin or me a call to discuss, if you have any questions.

Thanks,
Faizal