2008 Q2 – Liquidity Position

Liquidity pool

- Finished the second quarter with a record $44.6 billion of liquidity available to Holdings versus $34.3 billion at the end of the first quarter
  - Composition of the liquidity pool was as follows:
    - Cash instruments (deposits, MMFs) $4.1 bn
    - Govts / Agencies $36.6 bn
    - Investment grade corporate bonds $1.0 bn
    - Investment grade asset-backed $2.9 bn

- Neither of the two committed facilities amounting to $4.5 billion overall was drawn at quarter ends, although, as has been the case in previous quarters, they were drawn at various times during the quarter in the normal course of conducting business.

- Unencumbered assets in unregulated and regulated subsidiaries amounted to **approximately** $56 billion [includes the $7 billion derivatives adjustment] and $91 billion, respectively, at quarter end versus $64 billion and $97 billion, respectively at the end of the first quarter.
  - $9 billion decrease in the unregulated chain can be explained as follows:
    - $2 billion due to new external secured funding
    - $3 billion due to Freedom-type securitizations (part of liquidity pool)
    - $3 billion of external asset sales
  - $7 billion decrease in the regulated chain can be explained as follows:
    - Asset sale from bank entities: $7 billion

- Commercial paper and short-term debt amounted to $7.9 billion and $36.0 billion at quarter end, respectively versus $7.8 billion and $34.5 billion at the end of the first quarter, respectively.
  - Liquidity pool / STD ratio stood at 1.2x at quarter end versus 1.0x at the end of the first quarter.
  - Average life of our CP portfolio amounted to 41 days at quarter end

Cash capital

- Finished second quarter with a record cash capital surplus estimated at over $15 billion versus $7.0 billion at the end of the first quarter

- Issued an estimated $14.6 billion of long-term debt during Q2 versus $18.2 billion during the previous quarter. Additionally, issued $4.0 billion of mandatory convertible perpetual preferred in Q2 and $1.9 billion of perpetual preferred in Q1

- Bought back $3.3 billion of long-term debt during the quarter versus $3.4 billion during the first quarter

- As a result of finishing the quarter with such a strong capital surplus, no need to issue long-term for the remaining of the year (although we may do so to prefund 2009 debt issuance requirements).
  - Only $8 billion of long-term debt moving into current portion for the remainder of the year.

Secured funding

- Repo book amounted to $188 billion at the end of the quarter versus $231 billion at the end of the first quarter [$215 billion in Erin's Q1 speech].
  - Non traditional repo book (i.e., repo book excluding Government and Agency debt) amounted to $105 billion at the end of the quarter versus $116 billion at the end of the first quarter [$115 billion in Erin's Q1 speech].
  - 63% of the repo book ($118 billion: $78 billion traditional and $40 billion non-traditional repos) was funding Central Bank eligible collateral
    - $26 billion: PDCF eligible
    - $14 billion: ECB or other central bank eligible
  - Average tenor of the non-traditional repo book was 35 days at quarter end versus 22 days at the end of the first quarter [24 days in Erin's Q1 speech].
    - 46% of the non-traditional repo book had a maturity greater than a week at quarter end versus 25% at the end of the first quarter. Overnight repos amounted to 42% of the non-traditional repo book at quarter end versus 56% at the end of the first quarter.
    - Average tenor of repos for non-Central Bank eligible collateral was 38 days at the end of the quarter
    - Including cash capital facilities that are structured as repos, average tenor of the non-traditional repo book was 50 days at quarter end versus 42 days at the end of the first quarter.
  - Overfunding (defined as repo funding usage in excess of repo funding requirements) amounted to approximately $27 billion at the end of the quarter (~26% of non-traditional repo book) versus approximately $15 billion (~13% of non-traditional repo book) at the end of the first quarter.

Prime Broker

- Customer free credit balances in LBIE amounted to $4.0 billion at quarter end versus $7.8 billion [$5 billion in Erin's Q1 speech; she was referring to 3/17 not quarter end] at the end of the first quarter. They are included in the LBIE liquidity pool ($7 billion at quarter end – part of the unencumbered asset disclosure).

- Customer free credit balances in LBI amounted to $3.9 billion at quarter end versus $4.9 billion at the end of the first quarter. They are segregated from the Firm's liquidity per Regulation 15c3.

Bank Entities

- Lehman Brothers Bankhaus funded $29 billion of assets at quarter end versus $24 billion at the end of the first quarter. During the quarter, $3 billion of loans were transferred in offsetting loan sales or securitizations.
    - Long-term debt increased 16% during the quarter to $7.0 billion. Average life of LTD issued by Bankhaus remained at 9 years.
    - Additionally, Lehman Brothers Bankhaus has access to the European Central Bank's $750 billion tender facility program. This is a large, permanent program used by most banks in Europe to fund investment-grade Euro-denominated and registered collateral. During Q2 2008, it increased its usage of the facility by $4 billion to $10 billion – primarily asset-backed securities created by corporate and whole loan securitizations.

- Lehman Brothers Bank funded $11 billion of assets at quarter end versus $14 billion at the end of the first quarter. The decrease was essentially driven by a reduction in mortgages, the result of the suspension of wholesale and correspondent residential mortgage origination activities in the U.S., announced last January. It issued $270 million of CDs during the quarter.

- Lehman Brothers Commercial Bank funded $7 billion of assets at quarter end versus $7 billion at the end of the first quarter. It issued $846 million of CDs during the quarter.

Primary Dealer Credit Facility

- Lehman used the PDCF for test trades seven times during the quarter – typically $2 billion per test. It last tested the PDCF on April 16.

Freedom-type Securitizations

- During the quarter, Lehman created 12 securitization vehicles which "transformed" $21 billion of illiquid assets (residential and commercial whole loans and corporate loans) into $16 billion of investment-grade collateral pledgeable (or soon to be pledgeable for the most recent ones) to the Federal Reserve or ECB.

$ Millions

	Securitizations	Original size	Original investment grade portion	Current size	Current investment grade portion
U.S.	Freedom	2,825	2,260	1,926	1,541
	Spruce	1,874	1,462	1,874	1,462
	Pine	1,057	1,025	1,057	1,025
	RLT	1,664	332	765	133
	Sasco	3,435	2,050	3,435	2,050
		10,855	7,129	9,057	6,211
Europe	Excalibur	4,271	3,392	4,271	3,392
	Thalia	1,662	1,250	1,662	1,250
	Saphir	2,694	2,694	2,503	2,503
	ELQ1	412	323	412	323
	ELQ2	312	312	312	312
	EMF	668	585	668	585
	Mortgage Funding	2,020	1,727	2,020	1,727
		12,039	10,283	11,848	10,092
		22,894	17,412	20,905	16,303

Downgrade triggers

- The liquidity impact of a one-notch downgrade by S&P was $169 million gross and, because Morgan Stanley and Merrill Lynch were also downgraded that day, $159 million net
  - This was in line with our 2008 Q1 disclosure of a $0.2 billion liquidity impact in a case of a one notch downgrade (p. 71)

- Our 2008 Q1 10-Q also mentioned two other numbers
  - $4.3 billion, which is the margin amount that counterparties have the right to ask us to post even in the absence of a rating downgrade
    - The $4.3 billion has been substantially reduced during Q2 and, as of 5/30, has been reduced to $2.4 billion. Liquidity outflow associated with this risk is incorporated in our liquidity projections and included in our liquidity pool.
    - Note that it substantially overstates our liquidity risk because it does not include margin calls in our favor for which collateral has not been received (typically, collateral is posted a day after the call is made). As of 5/30, the $4.3 billion includes $0.7 billion of margin calls against us but does not include $0.5 billion of agreed margin postings that we had not yet received
  - $5.2 billion, which is the additional liquidity impact of a two notch downgrade
    - The incremental two notch impact of $5.2 billion is made up of two different populations of derivative trades - plain vanilla ones, for which the incremental liquidity risk of a two notch downgrade is trivial ($0.2 billion as of 2/29; $0.5 billion as of 5/30); and derivatives with SPVs (e.g., securitization vehicles and CDOs), for

which Lehman has typically 30 days if we are downgraded below A2/A to novate the trades or find a higher rated bank to act as an intermediary for us before we have to post the additional $5.0 billion margin (as of 2/29; roughly unchanged for 5/30).

- One of our secured bank facilities has a termination event in case of a downgrade: liquidity impact would a loss of $1.0 billion in case of a downgrade to Baa2 (or equivalent).
    - Additionally, a few have a rating band-based price schedule

Key Liquidity Metrics

$ billions, unless otherwise specified	2000	2002	2004	2006	2007	2008 Q1	Estimated 2008 Q2
LT Debt	28.3	30.7	49.4	81.2	123.2	128.3	129.4
ST Debt (<1 year)	12.8	10.3	10	20.6	28.3	34.5	36.0
CP Outstanding	3.6	1.6	1.7	1.7	3.1	7.8	7.9
Current portion of LT	7	8	7.1	12.9	16.8	18.5	20.8
Other ST	2.2	0.7	1.2	6.1	8.4	8.3	7.3
Total debt	**41**	**41**	**59.3**	**101.8**	**151.5**	**162.8**	**165.4**
Average life of CP (days)					51	52	41
Average life of LTD (years)	3.8	4	5.2	6.3	7.1	7.1	
Holdings liquidity pool at pledge value	N/A	16.0	19.0	31.0	35.0	34.3	44.6
Unencumbered collateral							
Unregulated entities	N/A	N/A	N/A	N/A	63	64	56
Regulated entities	N/A	N/A	N/A	N/A	95	97	91
Total					**158**	**166**	**147**
Liquidity pool / Short-term debt					124%	99%	124%
L. Pool + 70% of Unreg. Entities Unencumbered Collateral					280%	229%	233%
Cash capital surplus at Holdings	N/A	N/A	7.1	6.0	8.0	7.0	15.0
Non traditional repo book (excl. Govts+Agencies)							
Shell view					122.9	125.6	121
Collateral allocated view					111.3	116.4	105
Central Bank eligible							*40* (1)
Non Central Bank eligible							*65*
Overfunding					12	9	16
Maturity profile of repo book							
% O/N					52%	56%	42%
% <=1 wk					13%	18%	12%
% > 1wk					35%	25%	46%
Average tenor of repo book (days)					27	22	35
Avg. tenor of repo book including cash capital facilities					46	42	50

(1): 26 PDCF; 14 ECB and other CB