

Chronology of Selected Events Related to Lehman Brothers and the Possibility of Government Assistance

Date	Summary	Description
03/17/08	The FRBNY loans \$29 billion to Maiden Lane to facilitate JP Morgan's acquisition of Bear Stearns, establishes the PDCF and starts daily onsite monitoring of the investment banks.	<p>PDCF. FRBNY announces in a 3/16/08 press release that it has "been granted the authority to establish a Primary Dealer Credit Facility (PDCF)" that "is intended to improve the ability of primary dealers to provide financing to participants in securitization markets and promote the orderly functioning of financial markets more generally." The PDCF provided "overnight funding to primary dealers in exchange for a specified range of collateral, including all collateral eligible for tri-party repurchase agreements arranged by the Federal Reserve Bank of New York, as well as all investment-grade corporate securities, municipal securities, mortgage-backed securities and asset-backed securities for which a price is available." The FRBNY reported the PDCF would remain in operation for a minimum period of six months and that it might be extended as conditions warrant to foster the functioning of financial markets. Lehman draws \$1.6 billion from the PDCF on 3/18/08, \$2.3 billion on 3/19/08, \$2.3 billion on 3/20/08, \$2.13 billion on 3/24/08, 3/25/08 and 3/26/08 and \$2.0 billion on 4/16/08. It does not draw on the PDCF again until 9/15/08.</p> <p>Maiden Lane. FRBNY announces in 3/24/08 press release that it "will provide term financing to facilitate JPMorgan Chase & Co.'s acquisition of The Bear Stearns Companies Inc. ... to bolster market liquidity and promote orderly market functioning." The FRBNY reported that it would take, through a limited liability company formed for this purpose (Maiden Lane), control of a portfolio of assets valued at \$30 billion as of March 14, 2008, that would be pledged as security for a \$29 billion loan.</p> <p>On-site Monitoring of Investment Banks. The FRBNY begins onsite monitoring of investment banks with a focus on liquidity.</p> <p>TAB 1 FRBNY Press Release, Federal Reserve Announces Establishment of Primary Dealer Credit Facility, March 16, 2008 http://www.newyorkfed.org/newsevents/news/markets/2008/rp080316.html FRBNY Press Release, Statement on Financing Arrangement of JPMorgan Chase's Acquisition of Bear Stearns, March 24, 2008 http://www.newyorkfed.org/newsevents/news/markets/2008/rp080324.html See, e.g., FRBNY, Lehman IB Update (Aug. 27, 2008) [FRBNY to Exam. 007968] (a representative FRBNY daily report analyzing Lehman's liquidity pool, the status of Lehman's secured and unsecured funding, intraday funding, stock price, clearing bank actions, and significant stories about Lehman circulating in the press).</p>
3/18/08	Lehman reports better than expected 1Q08 results	<p>Lehman reports better than expected 1Q08 results and the Firm's stock price increases from \$31.75 on 3/17/08 to \$46.49 on 3/18/08.</p> <p>TAB 2 Earnings release available at: http://www.lehman.com/press/qe/past/1_08qe.htm</p>
4/15/08	Treasury official believes Lehman is gaming the PDCF	<p>Assistant Secretary for Economic Policy Phillip Swagel writes that Lehman is securitizing loans and keeping them on their books "to game the PDCF – they securitized their illiquid CLO's and got a rating agency to say that some large fraction of it was investment grade. And then poof, they get access to tens of billions of dollars from the Fed's PDCF."</p> <p>TAB 3 UST-FCIC 0030001</p>

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4/16/08	Emails between David Nason and Tom Russo re regulation of investment banks.	Treasury Assistant Secretary for Financial Institutions David Nason emails Lehman Chief Legal Officer Tom Russo and writes that “Secretary Paulson has asked me to visit with some of the large investment banking firms to get a sense of the firm’s current thinking on the types of regulation and supervision that might result from the Bear situation. As you can expect, there is a lot of interest in this issue now and it is likely that the Congress will focus on this...” TAB 4 UST-FCIC 0029516 - UST-FCIC 0029517
4/29/08	Emails between Mario Ugoletti and Jeremiah Norton re PDCF, TSLF and regulation of investment banks.	Treasury’s Director of the Office of Financial Institutions Policy Mario Ugoletti emails Deputy Assistant Secretary for Financial Institutions Policy Jeremiah Norton that he met separately with representatives from Goldman and Lehman’s Russo re the Primary Dealer Credit Facility (“PDCF”) and Term Securities Lending Facility (“TSLF”). Ugoletti writes that Russo supported “a framework that would provide discount window access to individual institutions and on a market-wide basis” and that it needed to be “implemented in a collaborative manner to avoid the stigma associated with discount window borrowing” including “anonymity and working together to solve problems.” TAB 5 UST-FCIC 0029512 - UST-FCIC 0029514
6/09/08	Lehman pre-announces 2Q08 net loss of \$2.8 billion.	Lehman’s first loss since going public. Stock declines from \$33.02 on 6/6/08 to \$29.24 on 6/9/08 due to higher-than expected loss. TAB 6 http://www.lehman.com/press/qe/past/2_08qe.htm
6/12/08	Lehman reports change in management	Lehman announces that Bart McDade will replace Joseph Gregory as President and COO, and that Ian Lowitt will replace Erin Callan as CFO.
6/16/08	Kirsten Harlow onsite monitoring report to FRBNY officials re Lehman’s earnings release	FRBNY onsite monitor Kirsten Harlow emails several FRBNY officials and reports that “Lehman’s earnings release today was largely in-line with last week’s pre-release. No adverse information on liquidity, novations, terminations or ability to fund either secured or unsecured balances has been reported.” Harlow also reports that Lehman has taken measures to strengthen liquidity and capital, including increasing liquidity pool from \$34 billion to \$45 billion, reducing assets, issuing \$4 billion of preferred shares and \$5.5 billion of long-term debt. TAB 7 Email from Kirsten Harlow, FRBNY to Tim Geithner, et al. (June 16, 2008) [FCIC-155446]
6/17/08	Email from William Dudley to Ben Bernanke, Tim Geithner and others re Lehman and PDCF.	FRBNY Executive Vice President of the Markets group Bill Dudley emails Federal Reserve Chairman Ben Bernanke, FRBNY President & CEO Geithner and others that PDCF and TSLF should be extended to the end of the year. He writes that the “PDCF remains critical to the stability of some of the IBs. Amounts don’t matter here, it is the fact that the PDCF underpins the triparty repo system. I think without the PDCF, Lehman might have experienced a full blown liquidity crisis. So this has to be kept as is until 1) the IBs are in better shape in terms of funding/leverage and 2) triparty is strengthened – both are in process.” TAB 8 6/17/08 email, FCIC 154463-464.
6/19-20/08	Kirsten Harlow onsite monitoring report to FRBNY officials re funding counterparties.	Kirsten Harlow reports that with respect to Lehman, there are “trading issues with four financial institutions: Natixis (eliminating all activity with Lehman), Santander, Wespac, and Commonwealth Bank of Australia.” Harlow also reports that Citi has “decided to reduce total clearing/settlement lines to Lehman from approximately \$20 billion to around \$10-12 billion” and that “Lehman has agreed to place \$2 billion cash with Citi, not as collateral but in case of difficulties.” Also reported that JPMC reported that “some large pension funds and some smaller Asian central banks are specifying (or tightening the standards on) what classes of assets they will accept” and that certain investors are “still refusing to deal with these seemingly weak counterparties” even though JPMC agreed to indemnify them. Fed Senior Advisor in the Division of Banking Supervision and Regulation Tim Clark responds that “this is not sounding good at all.” TAB 9 6/20/08 email, FCIC155450

Date	Summary	Description
6/25/08	Lehman fails FRBNY liquidity stress test.	A FRBNY liquidity stress projects \$66 billion of outflows and \$51 billion of liquidity. It concludes that “(1) Lehman’s weak liquidity position was driven by its relatively large exposure to overnight CP combined with significant overnight secured funding of less liquid assets, (2) one and two notch downgrades would result in significant collateral calls, (3) Lehman recognized its vulnerabilities and was trying to reduce illiquid assets and extend maturities, and (4) Lehman should improve liquidity by \$15 billion.” TAB 10 6/25/08 Primary Dealer Monitoring: Liquidity Stress Analysis, FCIC-155470-474, at 474.
7/10/08	Robert Hoyt email to Laurie Schaffer re Lehman Liquidity.	Treasury General Counsel Robert Hoyt writes in email to Treasury Assistant General Counsel for Banking and Finance Laurie Schaffer that “the real problem is 70 billion of illiquid bonds, so I assume finding liquidity for them is the key.” TAB 11 UST-FCIC 0029097
7/11/08	Treasury emails re options to minimize effects of Lehman failure.	Robert Hoyt writes that “the Fed has plenty of legal authority to provide liquidity, and if they choose not to, I doubt we would. So the real question may be what authorities can we exercise in a scenario where we want to let the firm fail, but then step in to minimize effects on creditors and the system. Basically a receivership option. Consider this – could we negotiate a pre-packaged bankruptcy where we provide funding, operate the business, and take care of creditors?” TAB 12 7/11/08 email, UST-FCIC 0029096.
7/11/08	Emails between Fed officials re Lehman funding counterparties pulling repo lines.	In response to report that Dreyfus and Federated pulled their repo lines from Lehman, Fed Deputy Director of the Research and Statistics Division Pat Parkinson writes that “there are other such reports but overall LB’s funding seems to have held up thus far. Lots of anxiety nonetheless.” TAB 13 7/11/08 email, FCIC-155481.
7/11/08	Emails between Fed officials re plan to provide tri-party repo funding to Lehman.	FRBNY staff informs Geithner of plan for Fed to step in to the shoes of clearing bank (JPMC or BoNY) because a clearing bank’s unwillingness to provide intra-day funding “could be disastrous for the firm and also cast widespread doubt about the instrument as a nearly risk free, liquid overnight investment.” TAB 14 7/11/08 memo, FCIC-155485-491
7/12-13/08	Emails between Fed officials re providing tri-party repo funding to Lehman.	Fed officials discuss whether the Fed would provide tri-party repo funding to Lehman without a buyer. FRBNY EVP & Director of Financial Research James McAndrews writes that “the thing we would have to decide is whether the distressed firm was likely to be sold. If we think that the run had progressed too far and that it wouldn’t be sold, then any lending we did to it would be a permanent addition to the government’s balance sheet – like Northern Rock, again. That is the crucial question at the time a decision must be made. If we think it can be sold, then proceed as in BS. If not, discuss with the Treasury its appetite for a permanent addition to the government’s balance sheet by lending to the distressed firm; if there is little appetite for that, then lend to the distressed firm’s creditors, and work to contain the spread of the problem with communication policy.” TAB 15 Email from Jamie McAndrews to Meg McConnell, et al., (July 12, 2008) [FCIC-155504 - FCIC-155506]

Date	Summary	Description
7/12-13/08	Emails between Fed officials re providing tri-party repo funding to Lehman.	<p>Fed officials continue to discuss providing tri-party repo funding to Lehman if “JPMC refuses to unwind LB’s triparty one morning out of fear of being caught with the entirety of this exposure when the music stops.”</p> <p>Fed Research Director Pat Parkinson responds that the Fed should be willing to lend to Lehman under the PDCF with conservative haircuts if Lehman was judged to be sound and that the Fed should tell JPM that with the PDCF in place, JPM’s “refusing to unwind is unnecessary and would be unforgiveable.” Parkinson also writes that “the point of our PDCF lending would be to head off a massive run” and that a run might still occur in a world where headline risk is an important concern.</p> <p>TAB 16 7/12-13/08 email, FCIC-15510-12.</p>
7/15/08	Bill Dudley email re Lehman Good Bank/Bad Bank Idea.	<p>FRBNY’s Bill Dudley proposes Maiden Lane type vehicle where \$60 billion of Lehman assets would be held by the SPV and financed by \$5 billion of Lehman equity and a \$55 billion loan from the Fed. Dudley writes that this proposal “[t]akes illiquid assets off the market, reduces risk that forced sale of assets will generate losses that make Lehman insolvent” and would “[p]reserve Lehman franchise as a going concern” and provide “[n]o externality to the rest of financial system. . . . Clean Lehman can be sold or remain a viable concern.”</p> <p>TAB 17 FCIC-154477.</p>
7/20/08	Pat Parkinson email to Ben Bernanke, Fed Governor Kevin Warsh, Fed General Counsel Scott Alvarez and Fed Director of the Division of Monetary Affairs Brian Madigan re options in the event of a run on Lehman	<p>Parkinson writes that “JPMC, LB’s clearing bank is likely to be the first to realize that the money funds and other investors that provide tri-party financing to LB are pulling back significantly. If some morning it fears that the investors are unlikely to roll their repos, it may threaten not to unwind LB’s previous night repos. If it did that, LB would be done because the tri-party investors would control its securities inventory. The investors presumably would promptly liquidate the \$200 billion of collateral and there is a good chance that investors would lose confidence in the tri-party mechanism and pull back from funding other dealers. Fear of those consequences is, of course, why we facilitated Bear’s acquisition by JPMC.” Parkinson continues that the Fed “could try to dissuade JPMC from refusing to unwind by pointing out that if the investors don’t roll the repos LB can borrow from us through the PDCF” but that JPMC “might still balk” because some collateral not eligible for PDCF and because JPMC “would be stuck with \$200 billion of secured loans to LB” if Lehman filed bankruptcy intra-day. “JPMC and BNYM are sufficiently concerned that they have arranged a meeting Monday afternoon with SIPC.”</p> <p>Parkinson also noted that even if the Fed “extended as much as \$200 billion of financing to LB, absent an acquirer our action would not ensure LB’s survival” because the stigma associated with PDCF borrowing could likely result in other liquidity demands that Lehman might not be able to meet.</p> <p>TAB 18 7/20/08 email, FCIC-154545.</p>
8/08/08	Emails between Fed officials re “gameplan” for potential Lehman failure.	<p>Fed’s Parkinson circulates “gameplan” to deal with a potential Lehman failure and includes the following: (1) identify activities whose liquidation under Chapter 11 could have a significant adverse effect on financial markets and the economy; (2) gather additional information about those activities to assess the likelihood of negative effects of liquidation; and (3) where there is serious potential for significant adverse effects, identify actions that the firm, its counterparties or the government could take to mitigate risk.” Fed and Treasury identify that the principal investment bank activities that could entail systemic risk are tri-party repo borrowings and OTC derivatives activities, that options to avoid a fire sale of tri-party repo collateral are not very attractive and that the Fed is still in the early stages of assessing the potential systemic risk from close-out of OTC derivatives transactions by an investment bank’s counterparties and identifying potential mitigants.</p> <p>TAB 19 FCIC 156050-156054</p>

Date	Summary	Description
8/14/08	FRBNY email re meeting with OTS and AIG liquidity concerns.	Kevin Coffee, from the FRBNY's Financial Sector Policy and Analysis group, emails FRBNY officials and notes that the OTS was generally comfortable with AIG's liquidity. TAB 20 FCIC-AIG0015409 - FCIC-AIG0015410
8/14/08	FRBNY summary of AIG Earnings, Capital and Liquidity Issues.	Stated in summary that "AIG is under increasing capital and liquidity pressure," that AIG "appears to need to raise substantial longer term funds to address the impact of deteriorating asset values on its capital and available liquidity as well as to address certain asset/liability funding mismatches." Also notes there may be a ratings downgrade. TAB 21 FCIC-AIG0015389- FCIC-AIG0015390
8/8-19/08	Emails between Fed and Treasury officials re risk of assembling industry group and collecting derivative data from Lehman.	Pat Parkinson and Steven Shafran, Senior Advisor to Treasury Secretary Paulson, exchange emails about the "gameplan" and the risk of forming a "default management group" composed of senior business representatives of major market participants that would work with regulatory authorities to consider and anticipate issues likely to arise in the event of a default of a major counterparty. Parkinson writes that they "would need to be careful not to suggest concerns about any particular market participant" but noted that "they no doubt would draw their own conclusions." Shafran responds that "this would make sense in a less stressed market" but that the "timing right now is problematic" because asking to form the group could "signal[] concerns that only exacerbate the issues." Parkinson responds, "I worry that without gathering more info we will not come up with a sensible gameplan." TAB 22 UST-FCIC 0029725 - UST-FCIC 0029730 On 8/15/08, FRBNY Vice President in the Bank Supervision Group William Brodows reports that FRBNY officials met with Lehman to get derivative-related information and that the meeting "caused a stir in Lehman and we had to assure them that our questions were not institution specific." Parkinson responded on 8/19/08 that he thought it was worth engaging the industry group even though there were risks and that they needed to better understand OTC derivative exposures. TAB 23 FCIC-156050 - FCIC-156051
9/2/08	FRBNY document titled "AIG Liquidity and Access to the PDCF."	Reported that "AIG's current liquidity position is precarious and asset liability management appears inadequate given firm's substantial off balance sheet liquidity needs" and that borrowing through the PDCF "could potentially allow AIG to unwind its positions in an orderly manner while satisfying its immediate liquidity demands, although it is questionable whether such a facility is necessary for the survival of the firm." TAB 24 FCIC-AIG0016236-39.
9/2-5/08	FRBNY summary of Lehman tri-party repos.	FRBNY summary of Lehman tri-party repos shows that balances ranged from \$149 billion to \$151 billion and that \$20.4 billion was not PDCF eligible. TAB 25 FCIC-154556 - FCIC-154563
9/05/08	Pat Parkinson email to Theodore Lubke re request for OTC derivatives information from Lehman, formation of industry group and "playbook" for investment bank failure that Paulson has been asking for.	Parkinson emails FRBNY Senior Vice President Theodore Lubke and writes that (1) the Fed is going to request OTC derivative information from Lehman, (2) Geithner will ask former FRBNY President Gerald Corrigan to accelerate the formation for a private sector default management group and (3) Lubke, Parkinson and Shafran will "create the 'playbook' for an IB failure that the Secretary has been asking for." TAB 26 FCIC-156055

Date	Summary	Description
9/7/08	Treasury places Fannie and Freddie into conservatorship and provides \$200 billion in aid.	Government places Fannie Mae and Freddie Mac into conservatorship, providing \$200 billion in federal aid. TAB 27 United States Treasury, Press Release: Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008), <i>available at</i> http://www.ustreas.gov/press/releases/hp1129.htm (last visited Jan. 31, 2010); Mark Jickling, Congressional Research Service, CRE Report for Congress: Fannie Mae and Freddie Mac in Conservatorship (Sept. 7, 2008), <i>available at</i> : http://fpc.state.gov/documents/organization/110097.pdf .
9/9/08	Public disclosure that KDB will not invest in Lehman.	Korea Development Bank announces that it ended its talks with Lehman, and Lehman's stock plunges 45%, its largest daily percentage decline. TAB 28 Email from Catherine Jones, Lehman, to Hugh E. McGee, III, Lehman, <i>et al.</i> (Sept. 9, 2008) [LBEXDOCID 131058] (forwarding Jin-Young Yook, <i>Korea FSC: KDB, Lehman Investment Talks Have Ended</i> , Dow Jones Int'l News, Sept. 9, 2008) 6 am: when Treasury staff tell Paulson of the failed KDB deal and that Fuld was "still clinging to the view that somehow or the other the Fed has the power to inject capital," Paulson "felt a wave of frustration. Tim Geithner and I had repeatedly told Dick that the government had no legal authority to inject capital in an investment bank. That was one reason I had been pushing him to find a buyer since Bear Stearns failed in March. Fuld had replaced Lehman's top management, laid off thousands of employees, and pitched restructuring ideas, but the firm's heavy exposure to mortgage-backed securities had discouraged suitors and left him unable to make a deal. Ken [Wilson] had been telling Dick with increasing urgency that he needed to be ready to sell, but Dick did not want to consider any offer below \$10 per share. Bear Stearns had gotten that, and he would accept nothing less for Lehman." Paulson calls BofA CEO Ken Lewis to reinitiate talks with Fuld, even though BofA had already considered Lehman twice that year. <i>Paulson, On the Brink at 173.</i>
9/9/08, 9:00 am	FRBNY Deputy Chief of Staff for Policy and Vice President Margaret McConnell email re meeting to discuss options for dealing with a failing nonbank.	FRB and FRBNY officials meet to discuss "near term options for dealing with a failing nonbank." TAB 29 FCIC-155639-647.
9/9/08, 10:14 am	Pat Parkinson email to Steven Shafran re Lehman concerns.	Parkinson emails Treasury's Shafran re concern that Lehman would announce further losses, might not succeed in raising new equity, and that Lehman was vulnerable to a loss of confidence even though its liquidity position was not as bad as Bear. TAB 30 UST-FCIC 0029680
9/9/08, 11:07 am	Margaret McConnell email to Fed officials re Lehman derivatives and tri-party repos	Margaret McConnell circulates list of Lehman derivative counterparties which show that Lehman had over 1.3 million derivative deals, a tri-party repo book "much larger than Bear's" (\$182 billion v. \$50-\$80 billion), and that the top 10 counterparties provided 80% of the financing. TAB 29 FCIC-155639-647.
9/9/08, 5:00 pm	Email scheduling meeting to discuss potential bankruptcy of Lehman.	Call between Secretary Paulson, Ben Bernanke, Tim Geithner, SEC Chairman Christopher Cox, and staff to discuss potential bankruptcy of Lehman. TAB 31 FCIC-154564; <i>Paulson, On the Brink</i> , p. 178

Date	Summary	Description
9/9/08, 5:20 pm	Jim Wilkinson email re bailing out Lehman.	Treasury Chief of Staff Jim Wilkinson writes that he “can’t stomach us bailing out lehman. Will be horrible in the press.” TAB 32 UST-FCIC 0029964.
9/9/08, 9:00 pm	Geithner meeting with Bernanke.	Geithner calls Bernanke after receiving information showing that Lehman’s tri-party repo book was much larger than Bear Stearns (\$182 billion versus \$50-\$80 billion). TAB 29 FCIC-155639-647.
9/10/08, 7:30 am	Lehman pre-announces 3Q08 results.	Lehman reports \$3.9 billion 3Q08 loss including \$5.6 billion of writedowns. It also announces plans to sell a majority stake in its asset-management unit, spin off commercial real estate holdings, and cuts its dividend. TAB 33 Final Transcript of Lehman Brothers Holdings Inc. Third Quarter 2008 Preliminary Earnings Call (Sept. 10, 2008) [LBHI_SEC07940_612771].
9/10/08, 8:30 - 9:30 am	FRB officials meet with Treasury officials	Conference call between Paulson, Bernanke, Geithner and staff. TAB 34 FCIC-154731.
9/10/08, 11:49 am	Matthew Rutherford email to Treasury officials re Lehman funding counterparties.	Treasury Deputy Assistant Secretary for Federal Finance Matthew Rutherford informs Treasury officials that he spoke to several large money funds that were concerned and reassigned their exposure, but no wholesale pull-back of lines. These funds “stressed that they saw negligible risk in maintaining these positions.” TAB 35 UST-FCIC 0029201.
9/10/08, 5:17 pm	Mark VanDerWeide email to Alvarez re Lehman options	Fed Assistant General Counsel Mark VanDerWeide emails FRBNY General Counsel Scott Alvarez that working groups had been directed to flesh out “[1] how a Fed-assisted BofA acquisition transaction might look,” “[2] how a private consortium of preferred equity investors transaction might look,” and “[3] how a Fed take out of tri-party repo lenders would look.” VanDerWeide notes that “Geithner seemed to think that Lehman would survive into the weekend, but may need some PDCF help.” TAB 36 FCIC-154786.
9/11/08, (time unknown)	Geithner tells FSA that government assistance is possible.	Geithner told the Lehman bankruptcy examiner that he told the FSA that government assistance was possible.
9/11/08, 6:55 am	Parkinson email re “liquidation consortium.”	Fed and Treasury staff circulate “liquidation consortium gameplan” to Fed Vice Chairman Donald Kohn, FRBNY General Counsel Alvarez and Fed Director of the Division of Monetary Affairs Brian Madigan. The gameplan is to convene CEOs of major counterparties of Lehman (tri-party repo, CDS and other OTC derivatives) who would be most adversely affected by a Lehman insolvency and to provide a forum where these firms could explore possibilities of joint funding mechanisms to avert a Lehman insolvency. The gameplan: <ul style="list-style-type: none"> • Notes that Paulson would tell representatives that that they had until the opening of business in Asia to come up with a plan to recapitalize Lehman to enable an orderly wind down and that the government was willing to let Lehman fail. • Refers to a “FRBNY financial commitment” and stated that “[w]e should have in mind a maximum number of how much we are willing to finance before the meeting starts, but not divulge our willingness to do so to the consortium... Terms of any liquidity support should be long enough to guard against a fire sale, but on a short enough fuse to encourage buyers of Lehman assets to come forward. Two months to a year in duration?” • Notes that “Lehman is bigger and more global than Bear Stearns.” TAB 37 FCIC-154768-773

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9/11/08, 8:26 am	Susan McCabe email to FRBNY officials re Lehman situation spinning out of control.	Susan McCabe email to Bill Dudley and others re negative market reaction to Lehman's 9/10/08 announcement, concerns about AIG and WaMu, and that the situation "is getting pretty scary and ugly again...They have much bigger counterparty risk than Bear did, especially in derivatives market, so the market is getting very spooked, nervous. Also have Aig, Wamu concerns. This is just spinning out of control again. Just fyi, this is shaping up as going to be a rough day." TAB 38 FCIC-154785.
9/11/08, 10:32 am	Hayley Boesky email re situation at Lehman.	FRBNY Vice President Hayley Boesky tells Fed officials that the head of Lehman's FI sales called and stated that (1) counterparty volumes were extremely low, (2) Lehman had received a handful of requests for unwinds but there were no problems in others taking Lehman credit in the broker market, (3) Barclays and Citi had agreed to a handful of requests to intermediate, (4) there had not been any denial of novations, (5) the prime brokerage business was losing balances and (6) the fixed income desk was funded through 9/12/08 but that Lehman employees and clients all understood that it was "close to the end game, but that they [were] not experiencing a full blown run." TAB 39 UST-FCIC 0029573.
9/11/08, 10:45 am	Jason Miu email to Bernanke re Lehman concerns.	FRBNY Markets Group analyst Jason Miu email to Chairman Bernanke states that (1) the markets continued to negatively react to Lehman's 9/10/08 announcement; (2) Moody's disclosed that Lehman's reorganization plan was insufficient to avoid a downgrade; (3) the consequences of a downgrade would be OTC derivative collateral postings of \$4.4 billion and possible pull back by funding counterparties; (4) it would be a much more complex proposition to unwind Lehman's positions than Bear Stearns because Lehman had twice as many positions; and (5) a worst case Lehman scenario could push hedge funds toward their NAV triggers. TAB 40 FCIC-154787-789
9/11/08, 10:46 am	Hayley Boesky email re Lehman options	Hayley Boesky forwards an email from hedge fund manager Louis Bacon that included a list of what the Fed or Treasury could do to help Lehman, including (1) Fed cutting rates, (2) Treasury announcing a large GSE MBS purchase program, (3) Treasury announcing a major expansion of funding to the FHLB system that would be passed on to banks via FHLB advances, (4) bank regulators cutting risk weightings on GSE-issued MBS and debt (on the basis that the government now backstopped the GSEs) to help banks with their capital problems, (5) FRBNY lending to Lehman through the PDCF and facilitating a transaction with a Maiden Lane structure. TAB 41 UST-FCIC 0029425-428.
9/11/08, 11:36 am	Hayley Boesky email re hedge funds leaving Lehman.	Hayley Boesky emails Fed official that "nearly every large HF (Moore, Cap. Tudor, Fortress, etc.) has called to tell me that others are refusing to take LEH's name" TAB 41 UST-FCIC 0029425-428.
9/11/08, 1:40 pm	FRBNY outline for meeting with Lehman counterparties.	FRBNY circulates outline to convene a representative group of Lehman counterparties and creditors to make plans in the event of a Lehman bankruptcy filing, including resolution of derivatives, swaps, QFCs, repos, commodities futures and other transactions outside the bankruptcy process. The group would hold off on exercising their contractual rights to close out their trades and instead establish a process to net down all exposures and use a common valuation for marking positions after the bankruptcy filing. TAB 42 FCIC-154818-820.
9/11/08, 1:46 pm	Bryan Corbett email to Nason re Lehman bailout.	Special Assistant to the President for Economic Policy Bryan Corbett emails Treasury Assistant Secretary for Financial Institutions David Nason and writes "get ready for the Lehman bailout." TAB 43 UST-FCIC 0029510

Date	Summary	Description
9/11/08, 4:15-6:18 pm	FRBNY circulates Lehman Counterparty Credit Risk Exposure Summary.	FRBNY circulates summary of large financial institution (“LFI”) exposures to Lehman that shows about \$3 billion of current exposure and about \$11 billion of potential exposure. Document shows that Barclays, Citi, and UBS had increased their exposure to Lehman since 2Q08 and that Credit Suisse, JPMC, BofA and Deutsche had reduced their exposures to Lehman. TAB 44 FCIC-155141 - FCIC-155143 and FCIC-155144-147.
9/11/08, 11:58 pm	Hayley Boesky email to FRBNY officials re hedge funds panicking.	Hayley Boesky writes that “I have spent the past 3 hours receiving calls from HFs. On a scale of 1 to 10, where 10 is Bear-Stearns-week-panic, I would put sentiment today at 12. People are expecting full blown recession, There is full expectation that Leh goes, wamu and then ML. Worries about GS and reports of losses in their PB business. Apparently GS had a lot of commodity HFs who took big losses. ALL begging, pleading for a large scale solution which spans beyond just LEH..... I felt I needed to relay the message given they all took the time to call and given the panic in their voices.” TAB 45 UST-FCIC 0029425
9/12/08, (time unknown)	Paulson tells FSA the government might provide assistance to Barclays.	According to the Lehman Bankruptcy examiner, Paulson told the FSA that the FRBNY might provide assistance to Barclays.
9/12/08, 1:28 am	FRBNY email attaching latest version of “Decision to File Bankruptcy” Document.	Theo Lubke emails “Decision to File Bankruptcy” document which states that Lehman would need to resolve a number of complex issues before electing to file and that there is a great deal of uncertainty about how unregistered Lehman affiliates would be liquidated and how foreign bankruptcy regimes operated. TAB 46 FCIC-154847 - FCIC-154850
9/12/08	Paulson and Bernanke breakfast meeting.	Paulson has breakfast with Bernanke and tells him that he “was hopeful but had serious doubts about both Bank of America and Barclays [coming into the weekend].” Bernanke allegedly tells Paulson, “We can only hope that if Lehman goes, the market will have had a lot of time to prepare for it.” Paulson, On the Brink at 187.
9/12/08, 8:49 am	Jim Wilkinson email to Secretary Paulson re Lehman bailout unimaginable.	Treasury’s Chief of Staff Wilkinson writes in an email that Paulson was going to New York to “sort through this Lehman mess” and that Wilkinson “[could not] imagine a scenario where we put in govt money.” TAB 47 UST-FCIC 0029418-424.
9/12/08, 3:00 pm	Secretary Paulson goes to New York and Chairman Bernanke stays in DC.	Paulson (with Wilkinson and others) leave DC for New York. Paulson, On the Brink at 187. Bernanke stays behind in DC because a possibility existed that Bernanke might need to convene a meeting of the Federal Reserve Board to exercise the Federal Reserve’s emergency lending powers under Section 13(3) of the Federal Reserve Act. Valukas Report at 618 (citing Examiner Interview of Bernanke at 9).
9/12/08, 3:21 pm	Emails between Governor Warsh and Nellie Liang	Fed Senior Associate Director Division of Research and Statistics Nellie Liang writes that “I know lots of balls in the air, but hope we don’t have to protect Lehman’s sub debt holders” and Warsh responds “I hope we don’t protect anything.” TAB 48 FCIC-154863

Date	Summary	Description
9/12/08, 3:35 pm	Jim Wilkinson emails SEC Chairman Cox a Financial Times article re no Lehman bailout.	Jim Wilkinson emails Christopher Cox an FT article, “No Fed Bail-Out this Time Around,” which reports that (1) Lehman is less involved in CDS and clearing system than Bear, (2) the markets has had 6 months after Bear to prepare for Lehman crisis, and (3) the Fed now has in place an emergency liquidity facility to guard against risk that Lehman could suffer the kind of sudden funding strike in repo market that sank Lehman, quoting a former Fed official that “Now there is an infrastructure to prevent a disorderly liquidation with the Fed willing to lend against good collateral.” It also quotes a private equity firm executive that “Lehman may be the poster child for enough is enough.” TAB 49 UST-FCIC 0029440
9/12/08, 4:23 pm	Don Kohn email to Bernanke and Warsh re no government assistance.	Fed Vice Chairman Kohn emails Bernanke and Fed Governor Warsh stating there is a strong predilection against government involvement beyond liquidity and that the Fed and Treasury were exploring the bankruptcy option as well as involving the private sector in a wind down outside bankruptcy but could not give 100% guarantees on what the perception of the situation would be Sunday evening. TAB 50 FCIC-154870-871
9/12/08, 5:21 pm	FRBNY General Counsel Tom Baxter emails Secretary Paulson’s opening remarks to Shafran.	Paulson’s opening remarks to private consortium include that (1) a “sudden and disorderly unwind [of Lehman] could have broad adverse effects on the capital markets, with significant risk of a precipitous drop in asset prices, the widening of spreads and reduced liquidity,” (2) “the financial community needs to come together to fashion an orderly resolution of the current situation,” and (3) Paulson could not “[contain] the damage” if the financial community failed to fashion an orderly resolution. TAB 51 UST-FCIC 0029633-35
9/12/08, (time unknown)	Meeting between FRBNY and AIG officials.	Notes show that (1) AIG is facing serious liquidity issues that threaten its survival viability, (2) potential credit rating agency downgrades would trigger billions of dollars in liquidity needs, (3) market are punishing AIG’s stock, (4) some banks already pulling away and turning down AIG in the secured repo market, (5) AIG having problems rolling commercial paper, (6) unwinding in the event of an AIG bankruptcy is likely to be very messy because of \$2.7 trillion derivatives book with \$1 trillion concentrated in 12 large counterparties. TAB 52 FCIC-AIG0021217- FCIC-AIG0021218
9/12/08, 6:45 pm	Lucinda Brickler email re possibility of JPMC not unwinding Lehman’s tri-party repos	FRBNY Senior Vice President Lucinda Brickler emails thoughts on triparty repo and writes that “I’ve attempted to capture everyone’s positions and concerns, so we’re all on the same page as we think about options. I’ve also attempted to briefly describe a few things we may need to consider in the event that JPMC refuses to unwind Lehman’s positions on Monday – assuming they’re still in business, but haven’t been rescued – and the policy makers believe an intervention is necessary to protect the market from the fallout from a sudden default. As always, your thoughts, questions, etc., are welcome. We obviously have some work to do if we think we want to consider options that go beyond the existing facilities.” TAB 53 FCIC-155903

Date	Summary	Description
9/12/08, 7:00 pm	Government officials meet with CEOs.	<p>Paulson, Cox and Geithner meet at the FRBNY building with CEOs from Goldman (Blankfein), Merrill (Thain), Morgan (Mack), JPM (Dimon), Citi (Pandit), CS (Dogan), and BoNY (Kelly), to discuss Lehman. Paulson states, “there will be no bailout for Lehman,” and “that there are two potential buyers for Lehman,” BofA and Barclays.</p> <p>Paulson, <u>On the Brink</u> at 192.</p> <ul style="list-style-type: none"> Geithner outlines 3 main groups for Lehman to work on the following: (1) “‘lights out’ scenario of a Lehman bankruptcy, focusing on Lehman’s vast skeins of derivatives, secured funding, and triparty repo transactions;” (2) “how the industry might buy all of Lehman with the intention of liquidating it over time – an approach similar to what Wall Street had done in the 1998 LTCM bailout;” (3) “examine how to finance the part of Lehman that a prospective buyer didn’t want.” Paulson, <u>On the Brink</u> at 193. Prepared statements drafted by Baxter tasks the consortium to fashion an orderly resolution of Lehman because “a sudden and disorderly unwind could have broad adverse effects on the capital markets, with a significant risk of a precipitous drop in asset prices, the widening of spreads and reduced liquidity” and that the Fed and Treasury “[could not] offer the prospect of containing the damage if that doesn’t occur.” <p>TAB 54 9/12/08 email and attached speaking notes, UST-FCIC 0029633-35.</p>
9/12/08, 8:49 pm	Parkinson responds to Brickler’s 6:45 pm email re plans if JPMC does not unwind Lehman’s tri-party repos.	<p>Parkinson writes, “I’m forced to guess why plans have changed. I assume the fundamental problem is that even after the parent files for bankruptcy, the SEC wants the b/d to live on and does not want us grabbing tri-party collateral and paying off investors? And/or that we don’t want to take OMO collateral because we can’t rehypothecate and funds rate would go to zero? In any event, this now looks to me like a godawful mess.”</p> <p>TAB 53 FCIC-155903</p>
9/12/08, 11:04 pm	Lucinda Brickler email responding to Pat Parkinson’s 8:49 pm email.	<p>Lucinda Brickler responds to Pat Parkinson’s 8:49 pm email and writes “There has also not been much appetite over the past few days for ideas that involve extending public support beyond the existing programs. These issues and speculation about how bankruptcy would likely unfold are the drivers of this thinking. The situation is fluid, however. The notes I have been sending are intended to test ideas and generate dialog.”</p> <p>TAB 53 FCIC-155902</p>
9/12/08, (late night, exact time unknown)	Discussions with BofA and Treasury officials.	<p>In a late-night conversation, BofA CEO Ken Lewis tells Paulson that BofA would only consider buying Lehman if the government would take around \$65 billion off Lehman’s books. When Paulson said no, Lewis bows out.</p> <p>TAB 55 CNNMoney.com, William D. Cohan, “Three Days that Shook the World,” Dec. 15, 2008 (hereinafter “CNN Article”)</p>

Date	Summary	Description
9/12/08, (time unknown)	Secretary Paulson discusses AIG at consortium.	<p>At the consortium, Paulson notes, “All the attendees knew how fraught the market was and that its problems went beyond Lehman. By now, everyone knew that AIG was in trouble. The insurance giant’s problems had been all over the news that day. Apart from the dramatic plunge in its shares, S&P’s had warned that it might downgrade the company’s credit rating; this would force AIG to produce billions in additional collateral. Then what? What was the point of having the private sector weaken itself further to save Lehman if someone else was going to need help afterward.” Paulson, <u>On the Brink</u> at 192.</p> <p>Earlier that day, FRBNY met with AIG executives re “serious liquidity issues that threaten its survival viability.” Notes from meeting indicate that (1) a ratings downgrade would lead to \$10 billion of collateral calls and another \$3 billion in liquidity needs, (2) some banks were already pulling away and turning down AIG in the secured repo borrowing markets, (3) AIG was having trouble rolling its commercial paper, (4) AIG estimated it had 5-10 days before it ran out of liquidity, (5) a bankruptcy of AIG would be “very messy” because \$1 trillion of a \$2.7 trillion derivative book was concentrated in 12 large counterparties, and (6) AIG explicitly asked about how to obtain a loan under section 13(3) of the Federal Reserve Act.” Geithner was advised that “[t]he key takeaway is that they [AIG] are potentially facing a severe run on their liquidity over the course of the next several (approx. 10) days if they are downgraded by Moody’s and S&P early next week.”</p> <p>TAB 56 FCIC-SSI0001367-1371, e-mail from Alejandro Torre, vice president, Federal Reserve Bank of New York, to Timothy F. Geithner, president, Federal Reserve Bank of New York, September 12, 2008.</p>
9/13/08, 10:53 am	VanDerWeide email responding to Brickler’s 9/12/08 11:04 pm email.	<p>VanDerWeide writes that various options need to be discussed.</p> <p>TAB 53 FCIC-155902</p>
9/13/08, 11:29 am	Timeline for 9/13-15/08 circulated to Fed officials.	<p>Master timeline for meetings on 9/13-9/15.</p> <p>TAB 57 FCIC-155172</p>
9/13/08, 2:31 pm	Bernanke email to Alvarez and Fed Governors re 7 pm conference call.	<p>Bernanke writes that during the 7 pm call, they “may want to discuss some broader issues, e.g., should we go to Congress to ask for other authorities.”</p> <p>TAB 58 FCIC-154949</p>
9/13/08, 2:34 pm	Wall Street Journal article, “Lehman Deal Could Come Tonight As High-Level Talks Continue” and other articles circulated.	<p>The articles report that biggest hurdle in discussions is whether government funding will be provided.</p> <p>TAB 59 FCIC-155927</p>
9/13/08, 3:29 pm to 5:55 pm	Emails between SIPC and Treasury re Lehman self liquidation.	<p>Harbeck (SIPC) and Nason (Treasury) discuss SIPC preparing pleadings to initiate a SIPA case against Lehman, that the SEC prefers a self liquidation but Lehman may file Chapter 7 liquidation instead.</p> <p>TAB 60 UST-FCIC 0029499</p>
9/13/08, 7:44 pm	Alvarez email re disclosing tri-party solution structure to JPMC.	<p>Alvarez tells VanDerWeide to not disclose tri-party solution structure to JPMC “if it’s the only question about how to manage the bankruptcy – don’t want to suggest Fed willingness to give JPMC cover to screw L or anyone else.”</p> <p>TAB 61 FCIC-154966</p>

Date	Summary	Description
9/13/08, 8:01 pm	Lehman prepared document re impact of default circulated to FRBNY officials.	Memo prepared by Lehman counsel circulated to FRBNY officials that “internal counsel described as their view on how a default for their B/D units may trigger a cascade of defaults through to the subs which have large OTC deriv books.” TAB 62 FCIC-155967-69
9/13/08, 8:40 pm	AIG Systemic Risk Analysis.	AIG systemic risk analysis circulated to FRBNY officials states that Fed lending to AIG “will further extend the universe of institutions with discount window access, thus changing expectations about future Fed behavior,” that “Fed wants to limit the systemic risk externalities, and the potential spillover onto the real economy” and that “estimates of systemic risk losses are potentially large.” TAB 56 FCIC0SSI0001367-71
9/13/08	BofA is out, Barclays remains, Lehman leaves FRBNY that night thinking it’s saved. AIG concerns linger.	Morning. With BofA out, the consortium examines Barclays’ proposal to acquire all of Lehman except for its real-estate asset book, which has a face value of \$40 billion (before write-downs). The consortium realizes that contrary to Lehman’s mark-down of the commercial real-estate assets to \$33 billion (from \$40 billion), the valuation is actually at \$25 billion. The consortium would therefore have to provide \$1 billion each to finance the \$15 billion of real-estate assets left behind by Barclays in what would remain of Lehman. TAB 55 CNNMoney.com, William D. Cohan, “Three Days that Shook the World,” Dec. 15, 2008 McDade, Lowitt and other Lehman executives spend all day at the FRBNY to provide information to Barclays and the consortium. Fuld stays behind in Lehman building. FCIC staff interview with McDade. Afternoon. Merrill CEO Thain calls and meets with BoA’s Lewis to discuss a deal. CNNMoney.com, William D. Cohan, “Three Days that Shook the World,” Dec. 15, 2008 (hereinafter “CNN Article”) Evening. Consortium works throughout the evening to put together a term sheet for how they would all agree to support Barclays’ acquisition of most of Lehman. TAB 55 CNNMoney.com, William D. Cohan, “Three Days that Shook the World,” Dec. 15, 2008.
9/14/08, 9:00 am	Government directs Lehman to file bankruptcy after the UK’s FSA decision re waiver. Fed expands PDCF to cover less liquid securities.	Consortium reassembles at the Fed and had outlines of a deal around financing. Treasury’s Shafran states that “[p]eople were happy with the term sheet, so there was a doable deal on the table.” TAB 55 CNNMoney.com, William D. Cohan, “Three Days that Shook the World,” Dec. 15, 2008. Consortium willing to finance approximately \$50 billion in assets that Barclays did not want to buy. FCIC staff interview with McDade and Baxter.
9/14/08, 7:46 am – 9:00 am	Wilkinson email to Staley that the government is “united behind no money” for Lehman.	Wilkinson emails JPM’s Jes Staley that he was meeting with Paulson and Geithner and that it “doesn’t seem like it is going to end pretty.” Staley responds, “the issue here is can we end it at lehman. What’s the solution for Merrill? And who loses on the triparty unwind? And what will you guys do in the end.” Wilkinson responds, “No way govt money is coming in... I’m here writing the usg coms plan for orderly unwind ... also just did a call with the WH and usg is united behind no money. No way in hell Paulson could blink now... we will know more after this ceo mtg this morning but I think we are headed for winddown unless Barclays deal gets untangled.” TAB 63 UST-FCIC0029411-0416.

Date	Summary	Description
9/14/08, 9:31 am	FRBNY email re assistance to AIG.	FRBNY's Ashcraft writes that "I think that a case can be made to lend to them given the potential market disruptions of the unwind." TAB 64 FCIC-AIG0021165-21172
9/14/08, 9:45 am	FSA rejects Barclays deal.	Paulson calls Lehman's President McDade and tells him that the "deal's off. The FSA has turned it down." The Financial Services Authority ("FSA") in London, the UK equivalent of the SEC – has rejected Barclays deal. TAB 55 CNNMoney.com, William D. Cohan, "Three Days that Shook the World," Dec. 15, 2008.
9/14/08, 9:12 am to 9:49 am	Emails between Financial Times reporter and Treasury's Davis re assistance to Lehman.	In response to a question whether Paulson's "firm no government money" would rule out some kind of short term bridging support while the acquisition of the problem asset portfolio by consortium was organized and implemented, Davis writes that "off the record, his view is that the existing tools should be used as needed. Existing tools include the PDCF." TAB 65 UST-FCIC 0029177
9/14/08, 10:00 am	Paulson and Geithner inform the Consortium of FSA's rejection of Barclays deal.	Paulson and Geithner brief the Consortium at the FRBNY re the FSA's rejection. Among the reasons for FSA's rejection are (1) "the overall size of the potential exposure that Barclays was taking on and whether Barclays was in good enough shape to do it," (2) "FSA was looking for some kind of a cap to avoid U.K. contagion, and the Fed had just said, 'No assistance for Lehman,'" (3) "Barclays wasn't really that serious about getting FSA approval." The FSA then concluded that based on the amount of diligence, the risk profile, and the lack of any assistance from the U.S. that they were not going to let it proceed." TAB 55 CNNMoney.com, William D. Cohan, "Three Days that Shook the World," Dec. 15, 2008
9/14/08, 11:25 am to 11:59 am	Emails between Wilkinson and Staley re possibility of Lehman assistance.	Staley writes "I think market can take the Lehman unwind, but there needs to be a bid for Merrill early in the week. If Merrill goes, the whole 2a7 funding of Wall Street stops and the Fed will have to step in a bigger way. Its getting heated here. And I think people are getting that Paulson wont move." Wilkinson responds that "At the end of the day fed will have to harden support to I banks" and that the "CEOs here are talking abt a private sector liquidity facility." TAB 63 UST-FCIC 0029411
9/14/08, (time unknown)	McDade calls Fuld to inform him the Government directed Lehman to file for bankruptcy.	McDade calls Fuld to inform him that the Government told Lehman to file for bankruptcy. McDade and his Lehman Team return to Lehman's headquarters. Paulson tells consortium to focus on a solution to stabilize the markets. FCIC staff interview with McDade, Cohen, and Fuld. TAB 55 CNNMoney.com, William D. Cohan, "Three Days that Shook the World," Dec. 15, 2008
9/14/08, 1:22 pm	Fed expands PDCF window.	Fed expands PDCF to cover more illiquid assets that broker-dealers could pledge to clearing banks. TAB 69
9/14/08, 3:03 pm	FRBNY officials inform Lehman it cannot access expanded PDCF window.	Kohn writes in 3:03 pm email to Bernanke that "just talked to Kevin. LEH heard about the pdcf enlargement and thought it was a lifeline, but they didn't understand it was limited to triparty. KW thinks everything's on track for 4:30ish. SEC will go first announcing Chapt. 11 for holding company. I haven't seen any details." TAB 66 FCIC-154997; FCIC staff interviews at McDade, Lowitt, and Baxter.
9/14/08, (time unknown)	FRBNY officials inform Lehman it cannot access expanded PDCF window.	On hearing about expanded PDCF window, Fuld and other Lehman executives thought that Lehman is saved and could open the following day. McDade, CFO Lowitt, counsel Harvey Miller, and other Lehman executives return to FRBNY to meet with FRBNY's Baxter and staff. Baxter tells them that Lehman cannot access the expanded window and had to file bankruptcy. McDade and Lehman staff present PowerPoint showing catastrophic consequence of Lehman bankruptcy, to no avail. FCIC staff interviews with McDade, Lowitt, and Baxter.

Date	Summary	Description
9/14/08, 4:16 pm	Bernanke email to Warsh regarding amount of capital injection that would have been necessary.	Bernanke emails Warsh, "In case I am asked: How much capital injection would have been needed to keep LEH alive as a going concern? I gather \$12B or so from the private guys together with Fed liquidity support was not enough." TAB 67 FCIC-155000
9/14/08, 5:53 pm	Treasury emails re Fed actions to address potential issues in the repo market.	Robert Hoyt writes to Schafer that he had not heard the Fed would (1) widen collateral acceptable for the PDCF, (2) adjust the schedule related to certain auctions and (3) provide 23(A) relief to the banks but knew they were working on relief in the wake of Lehman talks failing. TAB 68 UST-FCIC 0029475
9/14/08, 6:13 pm	Email re expansion of PDCF and 23A relief.	FRBNY Deputy Director of Banking Supervision Deborah Bailey writes in email to Fed officials that "Lots going on and little of it good!.... There will be some changes in the PDCF.... I have attached below the final draft notice for the 23a exemption ... which applies to those institutions which are engaged in triparty repo through JPMC and BNY. It is important to note that an institution is eligible unless they are specifically told by the FRB and/or the primary supervisors that they are not eligible." TAB 69 FCIC-155006-10
9/14/08, 7:23 pm	Listing of Lehman Triparty repos.	Lehman triparty repos \$94.8 billion. TAB 70 FCIC-155011-014
9/14/08, 8:37 pm	FRBNY circulates analysis of Lehman counterparty exposure.	FRBNY circulates analysis of Lehman's counterparty exposure showing that Lehman had \$24.6 billion in current payable exposures to the market including (1) \$818 million to \$2 billion to large financial institutions ("LFI"), (2) \$3 billion to commercial banks that were not large financial institutions, (3) \$11 billion to hedge funds and (4) \$7.9 billion to "other" institutions. Coryan Stefansson, a Fed Associate Director of Bank Supervision and Regulation, responded, "so for 818 million the tax payer is exposed for up to 90b???" TAB 70 FCIC-155014-15.
9/14/08, (evening, exact time unknown)	Lehman board votes on bankruptcy.	Bart McDade, Ian Lowitt, Lehman Counsel Harvey Miller and others return to the Lehman building where the Board of Directors were assembled to vote on the bankruptcy filing. Cox and Baxter calls into the Board meeting to direct Lehman to file bankruptcy. Miller's team prepares for a Chapter 11 filing – a reorganization plan, not a liquidation plan – for the Lehman parent company, allowing the operating subsidiaries, such as the broker/dealer and the asset management business, to continue operating outside of bankruptcy. FCIC staff interviews with McDade, Russo, and Miller.
9/15/08, 1:30-2:00 am	Lehman files bankruptcy, but LBI accesses PDCF for orderly wind down (filing for bankruptcy days later).	1:30 am, Lehman Brothers Holding Inc. files for bankruptcy, listing \$639 billion of assets with over 100,000 creditors in the largest bankruptcy in US History. That day, DOW declines 504 points. The Fed gives LBI, the broker dealer, access to PDCF, which Lehman uses three more times (\$28 billion on 9/15; \$19.7 billion on 9/16, and \$20.4 billion on 9/17) until Barclays stepped into the shoes of the Fed in providing financing to LBI.
9/15/08, 9:33 am	Fed email re Lehman broker dealer accessing PDCF.	VanDerWeide writes to Alvarez, "Are you OK with Lehman b/d accessing the PDCF today in light of its parent's chapter 11 bankruptcy? Or should we talk about this one more time. I think Baxter is doing some analysis/writeup on this issue." TAB 71 FCIC-155027

TAB 1



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PRESS RELEASE

Federal Reserve Announces Establishment of Primary Dealer Credit Facility

March 16, 2008

The Federal Reserve has announced that the Federal Reserve Bank of New York has been granted the authority to establish a Primary Dealer Credit Facility (PDCF). This facility is intended to improve the ability of primary dealers to provide financing to participants in securitization markets and promote the orderly functioning of financial markets more generally.

The PDCF will provide overnight funding to primary dealers in exchange for a specified range of collateral, including all collateral eligible for tri-party repurchase agreements arranged by the Federal Reserve Bank of New York, as well as all investment-grade corporate securities, municipal securities, mortgage-backed securities and asset-backed securities for which a price is available.

The PDCF will remain in operation for a minimum period of six months and may be extended as conditions warrant to foster the functioning of financial markets.

For more information, see

[Board of Governors Press Release](#) OFFSITE

[PDCF Program Terms and Conditions >>](#)

[Frequently Asked Questions >>](#)

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PRESS RELEASE

Statement on Financing Arrangement of JPMorgan Chase's Acquisition of Bear Stearns

March 24, 2008

At the closing of the merger, the Federal Reserve Bank of New York ("New York Fed") will provide term financing to facilitate JPMorgan Chase & Co.'s acquisition of The Bear Stearns Companies Inc. This action is being taken by the Federal Reserve, with the support of the Treasury Department, to bolster market liquidity and promote orderly market functioning.

The New York Fed will take, through a limited liability company formed for this purpose, control of a portfolio of assets valued at \$30 billion as of March 14, 2008. The assets will be pledged as security for \$29 billion in term financing from the New York Fed at its primary credit rate.

JPMorgan Chase will bear the first \$1 billion of any losses associated with the portfolio and any realized gains will accrue to the New York Fed. BlackRock Financial Management, Inc. will manage the portfolio under guidelines established by the New York Fed designed to minimize disruption to financial markets and maximize recovery value.

[Summary of Terms and Conditions Regarding the JPMorgan Chase Facility >>](#)

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TAB 2

Quarterly Earnings

>>First Quarter 2008 >>>Second Quarter 2008 >>>Third Quarter 2008

First Quarter 2008

Lehman Brothers Reports First Quarter Results

Reports Net Income of \$489 Million, or \$0.81 Earnings Per Share

NEW YORK, 18 March 2008

Lehman Brothers Holdings Inc. (ticker symbol: LEH) today reported net income of \$489 million, or \$0.81 per common share (diluted), for the first quarter ended February 29, 2008, representing decreases of 57% and 59%, respectively, from net income of \$1.15 billion, or \$1.96 per common share (diluted), reported for the first quarter of fiscal 2007. Fourth quarter fiscal 2007 net income was \$886 million, or \$1.54 per common share (diluted).

First Quarter Business Highlights

- Experienced record client activity across our Capital Markets businesses, which was offset, in part, by the effect of the continued dislocations in the credit markets that significantly impacted the Firm's results
- Maintained strong liquidity position, with the Holding Company having a liquidity pool of \$34 billion and unencumbered assets of \$64 billion, with an additional \$99 billion at our regulated entities, at quarter end
- Reported record net revenues in the Investment Management segment
- Ranked #2 in announced global M&A transactions for the first two months of calendar 2008, according to Thomson Financial

Chairman and Chief Executive Officer Richard S. Fuld, Jr. said, "In what remains a challenging operating environment, our results reflect the value of our continued commitment to building a diversified platform and our focus on managing risk and maintaining a strong capital and liquidity position. This strategy has allowed us to support our clients through these difficult and volatile markets, while continuing to build and strengthen our global franchise for our shareholders."

Net Revenues

Net revenues (total revenues less interest expense) for the first quarter of fiscal 2008 were \$3.5 billion, representing decreases of 31% and 20%, respectively, from \$5.0 billion reported in the first quarter of fiscal 2007 and \$4.4 billion reported in the fourth quarter of fiscal 2007. Net revenues for the first quarter of fiscal 2008 reflect negative mark to market adjustments of \$1.8 billion, net of gains on certain risk mitigation strategies and certain debt liabilities.

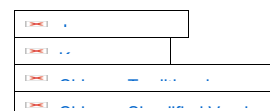
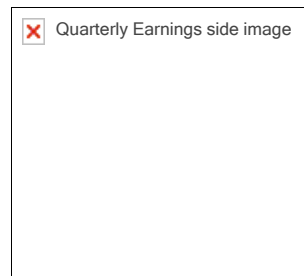
Business Segments

Capital Markets reported net revenues of \$1.7 billion in the first quarter of fiscal 2008, a decrease of 52% from \$3.5 billion in the first quarter of fiscal 2007. Fixed Income Capital Markets reported net revenues of \$262 million, a decrease of 88% from \$2.2 billion in the first quarter of fiscal 2007, as strong performances in liquid products such as high grade corporate debt, foreign exchange and interest rate products were offset, in part, by continued deterioration in the broader credit markets, in particular residential mortgages, commercial mortgages and acquisition finance. Equities Capital Markets reported net revenues of \$1.4 billion, an increase of 6% from \$1.3 billion in the first quarter of fiscal 2007, driven by continued growth in prime brokerage and strong activity in execution services.

Investment Banking reported net revenues of \$867 million, an increase of 2% from \$850 million in the first quarter of fiscal 2007.

These revenues were driven by strong merger and acquisition advisory revenues, which increased 34% to \$330 million from \$247 million in the first quarter of fiscal 2007, and higher equity origination revenues, which increased 23% to \$215 million from \$175 million in the first quarter of fiscal 2007, partially offset by lower revenues in debt origination as compared to the first quarter of fiscal 2007.

Investment Management reported record net revenues of



\$968 million, an increase of 39% from \$695 million in the first quarter of fiscal 2007. This performance was driven by record revenues in both Asset Management, which increased 49% to \$618 million from \$416 million in the first quarter of fiscal 2007, and Private Investment Management, which increased 25% to \$350 million from \$279 million in the first quarter of fiscal 2007. The Firm reported assets under management of \$277 billion, compared to \$282 billion at November 30, 2007.

Firm Profitability and Liquidity

Non-interest expenses for the first quarter of fiscal 2008 were \$2.8 billion, compared to \$3.3 billion in the first quarter of fiscal 2007 and \$3.2 billion in the fourth quarter of fiscal 2007. Compensation and benefits as a percentage of net revenues was 52.5% during the first quarter of fiscal 2008, compared to 49.3% for both the first and fourth quarters of fiscal 2007. Non-personnel expenses in the first quarter of fiscal 2008 were \$1.0 billion, consistent with the fourth quarter of fiscal 2007 and compared to \$860 million in the first quarter of fiscal 2007, reflecting continued investments in growing the franchise and costs associated with the resizing of the Firm's mortgage origination platform.

The Firm's pre-tax margin was 18.9% for the first quarter of fiscal 2008, compared to 33.7% for the first quarter of fiscal 2007. Return on average common equity was 8.6% for the first quarter of fiscal 2008, compared to 24.4% for the first quarter of fiscal 2007. Return on average tangible common equity was 10.6% for the first quarter of fiscal 2008, compared with 29.9% for the first quarter of fiscal 2007.

As of February 29, 2008, Lehman Brothers' total stockholders' equity was \$24.8 billion, and total long-term capital (stockholders' equity and long-term borrowings, excluding any borrowings with remaining maturities of less than twelve months) was \$153.2 billion. Book value per common share was \$39.45. The Holding Company had a robust liquidity pool of \$34 billion at quarter end. In addition, the Holding Company had other unencumbered assets of \$64 billion and our regulated entities had unencumbered assets of \$99 billion at quarter end.

Lehman Brothers (ticker symbol: LEH), an innovator in global finance, serves the financial needs of corporations, governments and municipalities, institutional clients, and high net worth individuals worldwide. Founded in 1850, Lehman Brothers maintains leadership positions in equity and fixed income sales, trading and research, investment banking, private investment management, asset management and private equity. The Firm is headquartered in New York, with regional headquarters in London and Tokyo, and operates in a network of offices around the world. For further information about Lehman Brothers' services, products and recruitment opportunities, visit the Firm's Web site at www.lehman.com. Lehman Brothers Inc. is a member of SIPC.

Conference Call

A conference call to discuss the Firm's financial results and outlook will be held today at 10:00 a.m. ET. The call will be open to the public. Members of the public who would like to access the conference call should dial, from the U.S., 800-619-3387 or, from outside the U.S., 415-228-4939 at least ten minutes prior to the start of the conference call. The pass code for all callers is LEHMAN. The conference call will also be accessible through the "Shareholders" section of the Firm's Web site under the subcategory "Webcasts." For those unable to listen to the live broadcast, a replay will be available on the Firm's Web site or by dialing 800-308-3945 (domestic) or 203-369-3240 (international). The replay will be available approximately one hour after the event and will remain available on the Lehman Brothers Web site and by phone until 11:59 p.m. ET on April 18, 2008.

Please direct any questions regarding the conference call to Ed Grieb at 212-526-0588, egrieb@lehman.com.

Cautionary Note Regarding Forward-Looking Statements

This press release may contain forward-looking statements. These statements are not historical facts, but instead represent only the Firm's expectations, estimates and projections regarding future events. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict, which may include risks and uncertainties relating to market fluctuations and volatility, industry competition and changes in the competitive environment, investor sentiment, liquidity and credit ratings, credit exposures, operational risks and legal and regulatory

matters. 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. The Firm undertakes no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. For more information concerning the risks and other factors that could affect the Firm's future results and financial condition, see "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Firm's most recent Annual Report on Form 10-K.



Selected Statistical and Financial Information Attached (255 k)

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TAB 3

From: Swagel, Phillip
Sent: Tuesday, April 15, 2008 12:11 PM
To: Gayer, Ted; Kashkari, Neel
Subject: RE: recap plan

Lehman has already done number 4 to game the PDCF -- they securitized their illiquid CLO's and got a rating agency to say that some large fraction of it was investment grade. And then poof, they get access to tens of billions of dollars from the Fed's PDCF.

From: Gayer, Ted
Sent: Tuesday, April 15, 2008 10:32 AM
To: Kashkari, Neel; Broome, Meredith; Burner, Gary; Grippo, Gary; Abbott, Matthew; Wheeler, Seth; Overlock, Garret; Swagel, Phillip; Schetzel, Michael
Subject: RE: recap plan

Neel-

This looks good. A few quick comments to consider:

- 1) I think the "allocation mechanism and pricing" section on page 3 should be more suggestive as a possible example, rather than sounding like this is the mechanism we endorse. As you note, the pricing mechanism is a key component of this proposal, and I fear linking the auction to recent book value might be a bad idea given that it rewards firms that didn't mark down appropriately. We don't want to pre-judge this decision for the private asset manager.
- 2) For the compensation section on page 3, I assume the government gets non-voting shares.
- 3) Shouldn't section 3 (p. 6) come after section 4 (p. 7)?
- 4) On the whole loans v. MBS, you should keep in mind that there is some evidence of institutions securitizing loans but keeping the security entirely on their portfolio. I'm not sure why this happens (perhaps there is an arbitrage opportunity from the ratings of the securities?), but such securities would be amenable to purchase under the whole loan plan. Nobody knows how many loans meet this criterion, but I wouldn't be surprised if the Fed says there are a lot.
- 5) I wonder to what extent government ownership of the high-risk MBS would lead to political pressure to modify/refinance the underlying loans. If government has majority ownership, is this enough to take them out of the trust? If not, I still fear later pressure to abrogate contracts.

Good luck with the meeting with Bernanke.

-Ted

From: Kashkari, Neel
Sent: Tuesday, April 15, 2008 9:49 AM
To: Broome, Meredith; Burner, Gary; Grippo, Gary; Abbott, Matthew; Wheeler, Seth; Overlock, Garret; Swagel, Phillip; Gayer, Ted; Schetzel, Michael
Subject: recap plan

Thanks to everyone who met last night on the recap contingency plan. here is the latest draft. if you could please review especially pages 2-4, that would be great and send me any comments this morning using track changes. we are seeing bernanke this afternoon with hank to walk them through it.

thanks

TAB 4

[REDACTED]

From: Nason, David
Sent: Monday, April 21, 2008 2:40 PM
To: 'Russo, Thomas A'
Cc: Hunt, Betty Ann
Subject: RE:

That would be excellent. Thank you

-----Original Message-----

From: Russo, Thomas A [mailto:trusso1@lehman.com]
Sent: Monday, April 21, 2008 1:33 PM
To: Nason, David
Subject: RE:

Mr. Nason:

Tom Russo is out of town today on business and asked that I reply to your meeting request. Tom has availability at 11:30am on Friday. Would you like me to set aside an hour?

Regards,
Cindy Sabia
Assistant to Tom Russo
Lehman Brothers
745 Seventh Avenue, 31st floor
New York, New York 10019
phone: 212-526-0477
fax: 212-526-2464

-----Original Message-----

From: David.Nason@do.treas.gov [mailto:David.Nason@do.treas.gov]
Sent: Monday, April 21, 2008 1:21 PM
To: Russo, Thomas A
Subject: RE:

I plan to be in NYC on Friday. Do you have any time available late morning or early afternoon?

-----Original Message-----

From: Russo, Thomas A [mailto:trusso1@lehman.com]
Sent: Friday, April 18, 2008 8:25 AM
To: Nason, David
Subject: Re:

Yes I am. Happy to meet with you. Tom

Sent from my BlackBerry Handheld.

----- Original Message -----

From: David.Nason@do.treas.gov <David.Nason@do.treas.gov>

To: Russo, Thomas A
Sent: Fri Apr 18 08:19:23 2008
Subject:

Tom -

Secretary Paulson has asked me to visit with some of the large investment banking firms to get a sense of the firm's current thinking on the types of regulation and supervision that might result from the Bear situation. As you can expect, there is a lot of interest in this issue now and it is likely that the Congress will focus on this (at least in the form of hearings) after they move some housing legislation. We have some views, of course, but at this point we want to know where the firms are leaning as that is an important part of our thought process. Are you the right point of contact for us to reach out to on this issue?

I hope you are well.

Best,

David

David G. Nason

Department of the Treasury

202.622.2610

david.nason@do.treas.gov

This message is intended only for the personal and confidential use of the designated recipient(s) named above. If you are not the intended recipient of this message you are hereby notified that any review, dissemination, distribution or copying of this message is strictly prohibited. This communication is for information purposes only and should not be regarded as an offer to sell or as a solicitation of an offer to buy any financial product, an official confirmation of any transaction, or as an official statement of Lehman Brothers. Email transmission cannot be guaranteed to be secure or error-free. Therefore, we do not represent that this information is complete or

TAB 5

[REDACTED]

From: mugoletti [REDACTED]
Sent: Tuesday, April 29, 2008 5:04 PM
To: Ugoletti, Mario
Cc: Norton, Jeremiah
Subject: Re: IBanks

[Jeremiah, here is a start from memory, I left my meager notes in the office, I will fill in the blanks and check the spelling of names in the morning. Anything else that you want to add let me know, Mario.]

Issue

The Federal Reserve has temporarily expanded liquidity options available to investment banks and primary dealers through two key programs.

(1) Primary Dealer Credit Facility -

(2) Term Securities Lending Facility (TSLF) -

Key issues associated with these changes include: have these liquidity facilities been effective; can these facilities be viewed as temporary, or have these actions created the perception of government support; should these facilities be made permanent; if so what type of regulation should accompany permanent access to Federal Reserve liquidity.

Below is a summary of the views of Goldman Sachs, Lehman Brothers, and SIFMA. We plan on going back to New York to discuss this further with Morgan Stanley and Merrill Lynch.

Goldman Sachs

- * Met with David Vinnier, Liz Belchtel, Greg Palm, and others.
- * Did one trial run of \$xxx million with the PDCF to see how it works, have made more extensive use of the TSLF.
- * PDCF not much value as a funding source for Goldman, but it has helped to stabilize the market.
- * TSLF has been useful as term secured funding has never been widely available. Now other firms are providing term secured funding, and the expectation is that this will continue even if the TSLF closes.
- * Key concerns with regulation surrounding any "permanent" type liquidity access are higher leverage capital requirements, activity restrictions, and micro-management of the firm.
- * Felt that if it was required, a higher leverage capital requirement could be managed, but it would involve moving more activities off-balance sheet.
- *

Activity restrictions could be problematic, especially as it relates to commodities and merchant banking.

*

So far the relationship with the on-site Federal Reserve examiners has been good as they have mostly been in an information gathering mode. Unclear that this time period is a good proxy for how future regulatory oversight might play out.

*

Tried to make the distinction that any change in regulation associated with a liquidity backstop should acknowledge the differences between institutions that make significant use of insured deposits and others. In particular, for Goldman, short-term secured funding is a small portion of overall liabilities.

Lehman Brothers

* Met with Tom Russo.

* Supports a framework that would provide discount window access to individual institutions and on a market-wide basis. Such a framework should be implemented in a collaborative manner to avoid the stigma associated with discount window borrowing. This would include anonymity and working together to solve problems.

* In such a framework additional safety and soundness regulation would be necessary. The distinction is that regulation should be focused on the Federal Reserve as a potential lender, as opposed to protecting insured depositors. Maybe 50 percent of the current regulations that apply to commercial banks would be appropriate for a lender-based regulatory framework.

* Need to consolidate regulation at the holding company level, in particular the holding company oversight of the OTS is duplicative and not particularly useful. The Federal Reserve is the logical choice as the consolidated supervisor.

* At this time they are actively considering all options in terms of corporate organization.

SIFMA

* Has circulated a list key questions to members: who should have access; what should the terms of access be; what type of regulation is necessary.

* Goal is to try to develop an industry position. That appears next to impossible.

* No firms came forth with any position. In particular, primary dealers of bank holding companies (e.g., Bank of America; Citigroup; and JP Morgan/Chase) said they were still considering the issue. As primary dealers with insured banks that already have access to the discount window, their views will likely be much different than more stand alone investment banks.

* Was some discussion of limiting access to investment banks with consolidated supervision. That would seem like a hard case to make, as it only exacerbates too-big or too-interconnected to fail.

----- Original Message -----

From: Mario.Ugoletti@do.treas.gov

To: mugoletti@msn.com

Sent: Tuesday, April 29, 2008 12:02 PM

Subject: IBanks

Issue

The Federal Reserve has temporarily expanded liquidity options available to investment banks and primary dealers through two key programs.

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(2) Term Securities Lending Facility (TSLF) -

Key issues associated with these changes include: have these liquidity facilities been effective; can these facilities be viewed as temporary, or have these actions created the perception of government support; should these facilities be made permanent; if so what type of regulation should accompany permanent access to Federal Reserve liquidity.

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Goldman Sachs

Lehman Brothers

SIFMA

TAB 6

Quarterly Earnings

>>First Quarter 2008 >>Second Quarter 2008 >>Third Quarter 2008

Second Quarter 2008

Lehman Brothers Reports Second Quarter Results

Reports Net Loss of \$2.8 billion, or (\$5.14) Per Share

NEW YORK, 16 June 2008

Lehman Brothers Holdings Inc. (ticker symbol: LEH) announced today a net loss of \$2.8 billion, or (\$5.14) per common share (diluted), for the second quarter ended May 31, 2008, compared to net income of \$489 million, or \$0.81 per common share (diluted), for the first quarter of fiscal 2008 and \$1.3 billion, or \$2.21 per common share (diluted), for the second quarter of fiscal 2007. For the first half of fiscal 2008, the Firm reported a net loss of approximately \$2.3 billion or (\$4.33) per common share (diluted), compared to net income of \$2.4 billion, or \$4.17 per common share (diluted), for the first half of fiscal 2007.

The Firm reported net revenues (total revenues less interest expense) for the second quarter of fiscal 2008 of negative (\$0.7) billion, compared to \$3.5 billion for the first quarter of 2008 and \$5.5 billion for the second quarter of fiscal 2007. Net revenues for the second quarter of fiscal 2008 reflect negative mark to market adjustments and principal trading losses, net of gains on certain debt liabilities. Additionally, the Firm incurred losses on hedges this quarter, as gains from some hedging activity were more than offset by other hedging losses. For the first six months of fiscal 2008, the Firm reported net revenues of \$2.8 billion, compared to \$10.6 billion for the first half of fiscal 2007.

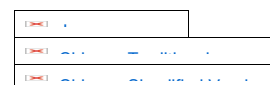
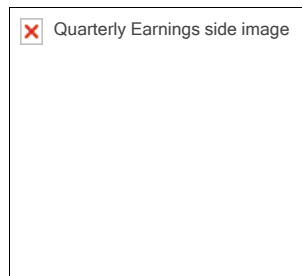
During the second quarter of fiscal 2008, the Firm further strengthened its liquidity and capital position (all below amounts as of May 31, 2008):

- Grew the Holding Company liquidity pool to \$45 billion from \$34 billion at the end of the prior quarter
- The Firm reported gross assets and net assets of approximately \$639 billion and \$327 billion, respectively, which decreased approximately \$147 billion and \$70 billion, respectively, from the first quarter of fiscal 2008
- Reduced gross leverage to 24.3x from 31.7x at the end of the first quarter, and reduced net leverage to 12.0x from 15.4x
- Reduced exposure to residential mortgages, commercial mortgages and real estate investments by approximately 20% in each asset class
- Reduced acquisition finance exposures by approximately 35%
- Reduced aggregate non-investment grade inventory (including funded acquisition finance assets) by approximately 20%
- Completed the budgeted full year fiscal 2008 unsecured funding plan
- Increased the Firm's long-term capital through the issuance of \$4.0 billion of convertible preferred stock in April and approximately \$5.5 billion of public benchmark long-term debt

Chairman and Chief Executive Officer Richard S. Fuld, Jr. said, "Since we announced our expected second quarter earnings last week, we have begun to take the necessary steps to restore the credibility of our great franchise and ensure that this quarter's unacceptable performance is not repeated. We have raised an additional \$6 billion of capital. I have asked Bart McDade, our best operator, to serve as the Firm's president and chief operating officer. I have also asked Ian Lowitt, our co-chief administrative officer, to be our chief financial officer. With these actions and our continued commitment to our client-driven franchise, we are positioned to take advantage of opportunities that lie ahead, and we are focused on maximizing shareholder value."

Business Segments

Capital Markets reported net revenues of negative (\$2.4) billion in the second quarter of fiscal 2008, compared to \$1.7 billion in the first quarter of fiscal 2008 and \$3.6 billion in the second quarter of fiscal 2007. Fixed Income Capital Markets reported net revenues of negative (\$3.0) billion, compared to \$0.3 billion in the first quarter of 2008 and \$1.9 billion in the second quarter of 2007. Excluding mark to market adjustments, related hedges and structured note liability



gains, client activity in securitized products, municipals and commodities remained strong, while credit, interest rate and financing were down from last quarter but each up versus the year ago period. Equities Capital Markets reported net revenues of \$0.6 billion, a decrease from \$1.4 billion in the first quarter of fiscal 2008 and \$1.7 billion in the second quarter of 2007, as record revenues in prime brokerage and solid execution services activity were offset, in part, by lower volatility revenues as well as losses of approximately \$0.3 billion on principal investments.

Investment Banking reported net revenues of \$0.9 billion, consistent with \$0.9 billion in the first quarter of fiscal 2008 and a decrease from \$1.2 billion in the second quarter of fiscal 2007. Debt underwriting revenues were \$0.3 billion, consistent with \$0.3 billion in the first quarter of fiscal 2008 and a decrease from \$0.5 billion in the second quarter of 2007, as strong high grade debt underwriting revenues were offset by continued weakness in high yield new issuance. Equity underwriting revenues were \$0.3 billion, an increase from \$0.2 billion in the first quarter of fiscal 2008 and consistent with \$0.3 billion in the second quarter of 2007. Merger and acquisition advisory revenues were \$0.2 billion, a decrease from \$0.3 billion in both the first quarter of fiscal 2008 and the second quarter of 2007.

Investment Management reported net revenues of \$0.8 billion, a decrease from record revenues of \$1.0 billion in the first quarter of fiscal 2008 and consistent with \$0.8 billion in the second quarter of fiscal 2007. Asset Management revenues were \$0.5 billion, a decrease from \$0.6 billion in the first quarter of fiscal 2008 on lower gains from minority interests in third party alternative investment managers, and consistent with \$0.5 billion in the second quarter of 2007. The Firm reported assets under management of \$277 billion, consistent with the prior quarter. Private Investment Management reported revenues of \$0.4 billion, consistent with \$0.4 billion in the first quarter of fiscal 2008 and an increase from \$0.3 billion in the second quarter of 2007, with strength across both fixed income and equity products.

Firm Profitability and Capital

Non-interest expenses for the second quarter of fiscal 2008 were \$3.4 billion, compared to \$2.8 billion in the first quarter of fiscal 2008 and \$3.6 billion in the second quarter of fiscal 2007. Compensation expense was approximately \$2.3 billion in the second quarter of 2008, compared to \$1.8 billion in the first quarter of fiscal 2008. Non-personnel expenses for the period were approximately \$1.1 billion, compared to \$1.0 billion in the first quarter of fiscal 2008. The tax rate was 32.1%.

As of May 31, 2008, Lehman Brothers' total stockholders' equity was \$26.3 billion, and total long-term capital (stockholders' equity and long-term borrowings, excluding any borrowings with remaining maturities of less than twelve months) was \$154.5 billion. Book value per common share was \$34.21.

In June, Lehman Brothers closed a \$4.0 billion public offering of 143 million shares of common stock as well as a \$2.0 billion public offering of 2 million shares of 8.75% non-cumulative mandatory convertible preferred stock, Series Q. The capital and equity statistics in this Press Release do not reflect the impact of these offerings.

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at least fifteen minutes prior to the start of the conference call. The pass code for all callers is "3713056". For those unable to listen to the live broadcast, a replay will be available on the Firm's Web site or by dialing 1-800-890-3520 (domestic) or 1-203-369-3844 (international). The replay will be available immediately after the beginning of the call and will remain available on the Lehman Brothers Web site and by phone until 11:59 p.m. ET on July 16, 2008.

Please direct any questions regarding the conference call to Ed Grieb at 212-526-0588, egrieb@lehman.com.

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Selected Statistical and Financial Information (252 k)



Financial Supplement (38 k)

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TAB 7

From: [Kirsten Harlow](#)
To: [Adam J Weisz](#); [Alexander J Psomas](#); [Amy White](#); [Angela MIKNIUS](#); [Arthur Angulo](#); [Brian Begalle](#); [Brian Peters](#); [Christopher Calabria](#); [Daniel Sullivan](#); [Denise Goodstein](#); [Dennis Herbst](#); [Dianne Dobbeck](#); [Elizabeth Tafone](#); [Gerard Dages](#); [Helen Mucciolo](#); [Homer Hill](#); [James P Bergin](#); [Jan Voigts](#); [Jeffrey Kowalak](#); [Jim Mahoney](#); [John Leiby](#); [JohnP McGowan](#); [Jonathan Stewart](#); [Kevin Coffey](#); [Kevin Messina](#); [Kirsten Harlow](#); [Lance Auer](#); [Michael Holscher](#); [Robard Williams](#); [Sarah Dahlgren](#); [Steven J Manzari](#); [Theodore Lubke](#); [Til Schuermann](#); [Tim P Clark](#); [Timothy Geithner](#); [William BRODOWS](#); [William Rutledge](#); [YoonHi Greene](#)
Subject: On-Site Primary Dealer Update: June 16
Date: 06/16/2008 05:09 PM
Attachments: [IB Financing Liquidity Master New.pdf](#)

Kirsten J. Harlow
Federal Reserve Bank of New York
(212) 720-2912
kirsten.harlow@ny.frb.org

ON-SITE TEAMS REPORT

Summary: Lehman's earnings release today was largely in-line with last week's pre-release. No adverse information on liquidity, novations, terminations or ability to fund either secured or unsecured balances has been reported.

Lehman Earnings Release:

Highlights:

- Earnings: Net loss of \$2.8 billion, compared to \$0.5 billion in the 1Q08 and \$1.3 billion in 2Q07
- Revenue: Net revenue of negative (\$0.7) billion, compared to \$3.5 billion in the 1Q08 and \$5.5 billion in 2Q07
- Economic hedges: Provided no benefit (previously found to be 70% effective)
- Asset Markdowns: Marked down approximately \$4 billion of illiquid assets, of which 50% was residential mortgage-related, and 25% of commercial mortgage-related.

Measures taken in 2Q08 to strengthen Liquidity and Capital:

- Increased the liquidity pool from \$34 billion to \$45 billion
- Reduced gross and net assets by \$147 billion and \$70 billion, respectively
- Improved gross and net leverage ratios from 31.7x to 24.3x and 15.4x to 12.0x, respectively
- Reduced exposures to residential mortgages, commercial mortgages and real estate investments by 20% in each asset class
- Issued \$4 billion in convertible preferred stock in April and \$5.5 billion of public long-term debt in the quarter

Counterparty Credit Issues for Secured and Unsecured Financing

Goldman: Fidelity has indicated having no interest in renewing a \$1 billion prom note that is maturing today. Goldman did, however, add a new \$500mm 7-day low-grade equity repo.

Parent Company Liquidity Pool



[IB_Financing_Liquidity_Master_New.pdf](#)

TAB 8

From: [William Dudley](#)
To: Chairman's
Cc: [Brian F. Madigan](#); [Donald L. Kohn](#); Chairman's ; [Timothy Geithner](#)
Subject: Re: TSLF
Date: 06/17/2008 08:20 AM

My two cents after consulting with Brian:

I agree with Tim that we should extend both through yearend--probably to January 31 or so. Sooner is better to provide clarity on this issue.

TSLF is a bit different than PDCF in that it is an auction, less of a backstop, available only for AAA-rated collateral and has been mostly undersubscribed. It seems to me that this argues for beginning to phase it out by cutting down the sizes of the auctions, and I might make this part of the overall announcement--extending it but starting to cut back the amount. This will underscore to people that these programs are not permanent and may help to mollify some of the critics a bit. I would not make a distinction here betw Schedule 1 and 2 (even though there is a difference) just to keep the message simple--both have been undersubscribed so we are going to begin to phase them out.

PDCF remains critical to the stability of some of the IBs. Amounts don't matter here, it is the fact that the PDCF underpins the triparty repo system. I think without the PDCF, Lehman might have experienced a full blown liquidity crisis. So this has to be kept as is until 1) the IBs are in better shape in terms of funding/leverage and 2) triparty is strengthened--both are in process.

So I (and I think Brian is on board with this) might propose a memo to the FOMC that extends both programs but also announces the phasing down of TSLF auction sizes beginning in July or August (depends on how much warning we want to give).

Best,
Bill



Chairman's Email

Chairman's
Email

06/16/2008 06:31 PM

To: Donald L. Kohn/BOARD/FRS@BOARD, Timothy Geithner/NY/FRS@FRS, William Dudley/NY/FRS@FRS, Brian F. Madigan/BOARD/FRS@BOARD

cc

Chairman's Email

Subject: Re: TSLF

Ok. Then we need to outline a short memo to the fomc from brian. I have no time till tomw afternoon but can take a stab at it then.

Sent from my BlackBerry Wireless Handheld

▼ Donald L Kohn

----- Original Message -----

From: Donald L Kohn
Sent: 6:25 PM EDT
To: Chairman's Email Timothy Geithner; William Dudley; Brian Madigan
Subject: Re: TSLF

Both the tslf and the pdcf depended on 13-3, though the latter gets all the attention. If we don't extend tslf does that raise questions about the need for the pdcf. Besides I like the idea of keeping the auction facilities alive, at least in some form. Getting the fomc to sign onto an extension could be tough and will require, as you note, some consideration of the broader picture for after September. But I think the discussion, like cod liver oil, will be good for us. If we can't convince most of our colleagues we will have problems with the public.

Sent from my BlackBerry Wireless Handheld

▼ Chairman's Email

----- Original Message -----

From: Chairman's Email
Sent: :12 PM EDT
To: Timothy Geithner; William Dudley; Brian Madigan; Donald Kohn
Subject: TSLF

If we are going to announce an extension of the TSLF in July, we probably should get the authority from the FOMC to do so. If we want to do that, then we need a short memo in advance of the meeting. At the meeting I could explain the reason for the request in more detail in the context of our discussion of plans for investment bank supervision.

Before thinking through what the memo would say, let me ask the following: Given that the TSLF has been undersubscribed, do we want to announce its extension? We could for example extend the PDCF in July (by Board decision) but say that we are reserving judgment on the TSLF. We could then revisit the TSLF at the August meeting. Thoughts?

TAB 9

From: [Tim P Clark](#)
To: [Robard Williams](#); [Kevin Coffey](#)
Subject: Fw: On-Site Primary Dealer Update: June 19
Date: 06/20/2008 08:58 AM
Attachments: [IB Financing Liquidity Master New.pdf](#)

this is not sounding good at all...

----- Forwarded by Tim P Clark/BOARD/FRS on 06/20/2008 08:57 AM -----

**Kirsten
Harlow/NY/FRS@FRS**

06/19/2008 09:06 PM

To Adam J Weisz/NY/FRS@FRS, Alexander J Psomas/NY/FRS@FRS, Amy White/NY/FRS@FRS, Angela MIKNIUS/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Brian Begalle/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Christopher Calabia/NY/FRS@FRS, Daniel Sullivan/NY/FRS@FRS, Denise Goodstein/NY/FRS@FRS, Dennis Herbst/NY/FRS@FRS, Dianne Dobbeck/NY/FRS@FRS, Elizabeth Tafone/NY/FRS@FRS, Gerard Dages/NY/FRS@FRS, Helen Mucciolo/NY/FRS@FRS, Homer Hill/NY/FRS@FRS, James P Bergin/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, Jeffrey Kowalak/NY/FRS@FRS, Jim Mahoney/NY/FRS@FRS, John Leiby/NY/FRS@FRS, JohnP McGowan/NY/FRS@FRS, Jonathan Stewart/NY/FRS@FRS, Kevin Coffey/NY/FRS@FRS, Kevin Messina/NY/FRS@FRS, Kirsten Harlow/NY/FRS@FRS, Lance Auer/NY/FRS@FRS, Michael Holscher/NY/FRS@FRS, Robard Williams/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS, Steven J Manzari/NY/FRS@FRS, Theodore Lubke/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, Tim P Clark/BOARD/FRS@BOARD, Timothy Geithner/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, William Rutledge/NY/FRS@FRS, YoonHi Greene/NY/FRS@FRS

cc

Subject On-Site Primary Dealer Update: June 19

Kirsten J. Harlow
Federal Reserve Bank of New York
(212) 720-2912
kirsten.harlow@ny.frb.org

ON-SITE TEAMS REPORT

Counterparty Credit Issues for Secured and Unsecured Financing/Other

Lehman: Acknowledged trading issues with four financial institutions: **Natixis** (eliminating all activity with Lehman), **Santander**, **Wespac**, and **Commonwealth Bank of Australia**.

Merrill: Since June 13 the total repo book declined by \$39 billion to \$196 billion and will continue to lower \$11 billion more going into quarter end on June 27. Management intends on reducing the size of its balance sheet usage through customer matched repo/reverse repo activity.

Parent Company Liquidity Pool

Merrill: Operating cash and liquidity at the holding company increased by \$5 billion closing at \$66.1 billion on Wednesday. The major inflows consisted of \$1.8 billion from domestic stock loan, \$1.1 billion from equity triparty, \$900 million from ML Pro (unwinding of short positions), \$ 500 million from corporate services triparty and \$500 million back from prior day government fails.



IB_Financing_Liquidity_Master_New.pdf

Comments Submitted by CPC Teams

JPMC: Some large pension funds and some smaller Asian central banks are specifying (or tightening the standards on) what classes of assets they will accept. Some are switching to repo only, and away from ABCP and Time Deposits. JPMC indicated that it will indemnify against losses on some of these counterparties (the names which are coming up in the market as generating the most concerns are Lehman and Merrill). Despite JPMC's indemnification, certain investors are still refusing to deal with these seemingly weak counterparties.

Citi: has decided to reduce total clearing/settlement lines to **Lehman** from approximately \$20 billion to around \$10-12 billion. Further, **Lehman** has agreed to place \$2 billion cash with Citi, not as collateral but in case of difficulties. The cash could also be used to fund any intra-day credit extensions. It should be noted that Citi is Lehman's largest clearer outside the United States. Tom said this approach will **also be applied to the other 3 major Broker/Dealers.**

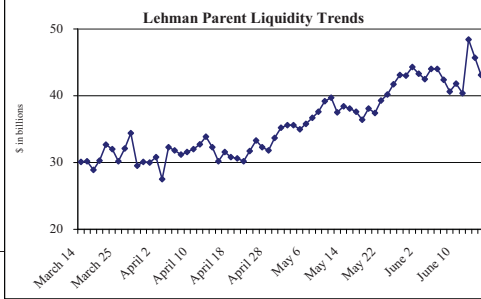
KEY METRICS: PRIMARY DEALER FINANCING AND LIQUIDITY

June 19, 2008

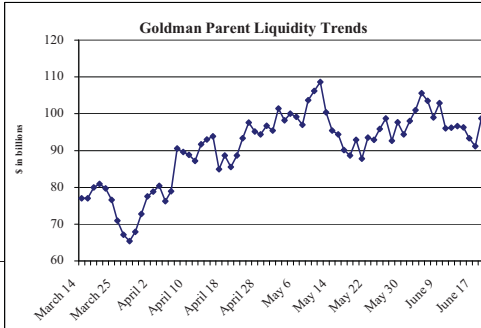
Preliminary

The first two columns below present secured and unsecured financing that did not roll on the day noted, as well as any reductions in credit lines, as reported to the on site FRBNY staff. A dash in the secured and unsecured columns indicates that there were no counterparty turn downs on that date. The third column presents maturity of the total outstanding CP, while the fourth column displays the parent company liquidity pool.

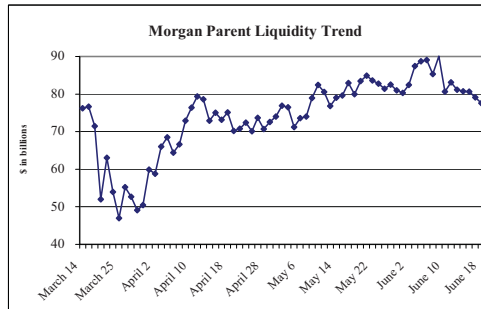
LEHMAN				
	Secured Financing	Unsecured Financing	CP: O/N as a % of Total	Parent Co. Liquidity Pool (EOD)
(\$ in billions)	Did not roll	Did not roll		
June 6	-	0.5	41%	42.4
June 9	1.7	1.3	33%	40.6
June 10	-	0.1	37%	41.8
June 11	0.3	-	37%	40.4
June 12	0.4	-	42%	48.4
June 13	3.0	1.7	21%	45.7
June 16			25%	42.6
June 17			18%	41.5
June 18	9.0	0.1	31%	43.1



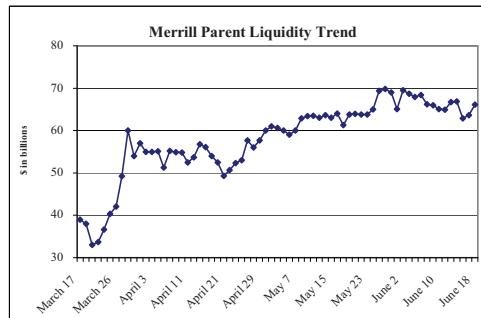
GOLDMAN SACHS				
	Secured Financing	Unsecured Financing	CP WAM	Parent Co. Liquidity Pool (EOD)
(\$ in billions)	Did not roll	Did not roll		
June 5	-	0.1	31	103.5
June 6	-	0.4	30	99.0
June 9	-	-	31	102.9
June 10	1.3	-	30	96.1
June 11	0.8	-	30	96.2
June 12	-	-	30	96.7
June 13	-	1.0	32	96.3
June 16	-	-	32	93.3
June 17	-	2.5	32	91.2
June 18	-	0.2		98.7



MORGAN STANLEY				
	Secured Financing	Unsecured Financing	CP WAM	Parent Co. Liquidity Pool (EOD)
(\$ in billions)	Did not roll	Did not roll		
June 6	-	-	63	85.3
June 9	-	-	61	90.1
June 10	-	-	60	80.7
June 11	-	-	60	83.1
June 12	-	-	59	81.2
June 13	-	-	62	80.7
June 16	-	-	62	80.7
June 17	-	-	61	79.1
June 18	-	-	63	77.6

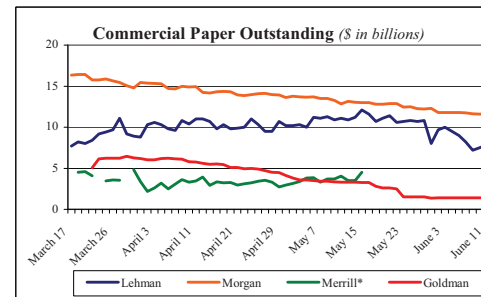


MERRILL LYNCH			
	Secured Financing	Unsecured Financing	Parent Co. Liquidity Pool (EOD)
(\$ in billions)	Did not roll	Did not roll	
June 6	-	-	66.2
June 9	-	0.3	66.0
June 10	-	0.2	65.1
June 11	-	0.0	64.9
June 12	-	0.4	66.7
June 13	-	-	66.9
June 16	-	-	62.9
June 17	-	-	63.6
June 18	-	-	66.1



COMMERCIAL PAPER OUTSTANDING				
(\$ in billions)	Lehman	Morgan	Merrill*	Goldman
June 6	8.2	11.8		1.4
June 9	7.2	11.6	3.8	1.4
June 10	7.5	11.6		1.4
June 11	7.8	11.6		1.4
June 12	7.9	11.6		1.4
June 13	6.1	11.1	3.1	1.4
June 16	5.6	10.8		1.7
June 17	5.6	10.9		1.7
June 18	6.5	10.8		

* Only represents CP outstanding for the next two weeks



Source: Estimated from IB reports and onsite team updates; data supporting secured / unsecured may be incomplete.

TAB 10

Primary Dealer Monitoring: Liquidity Stress Analysis

June 25, 2008



FEDERAL RESERVE BANK *of* NEW YORK

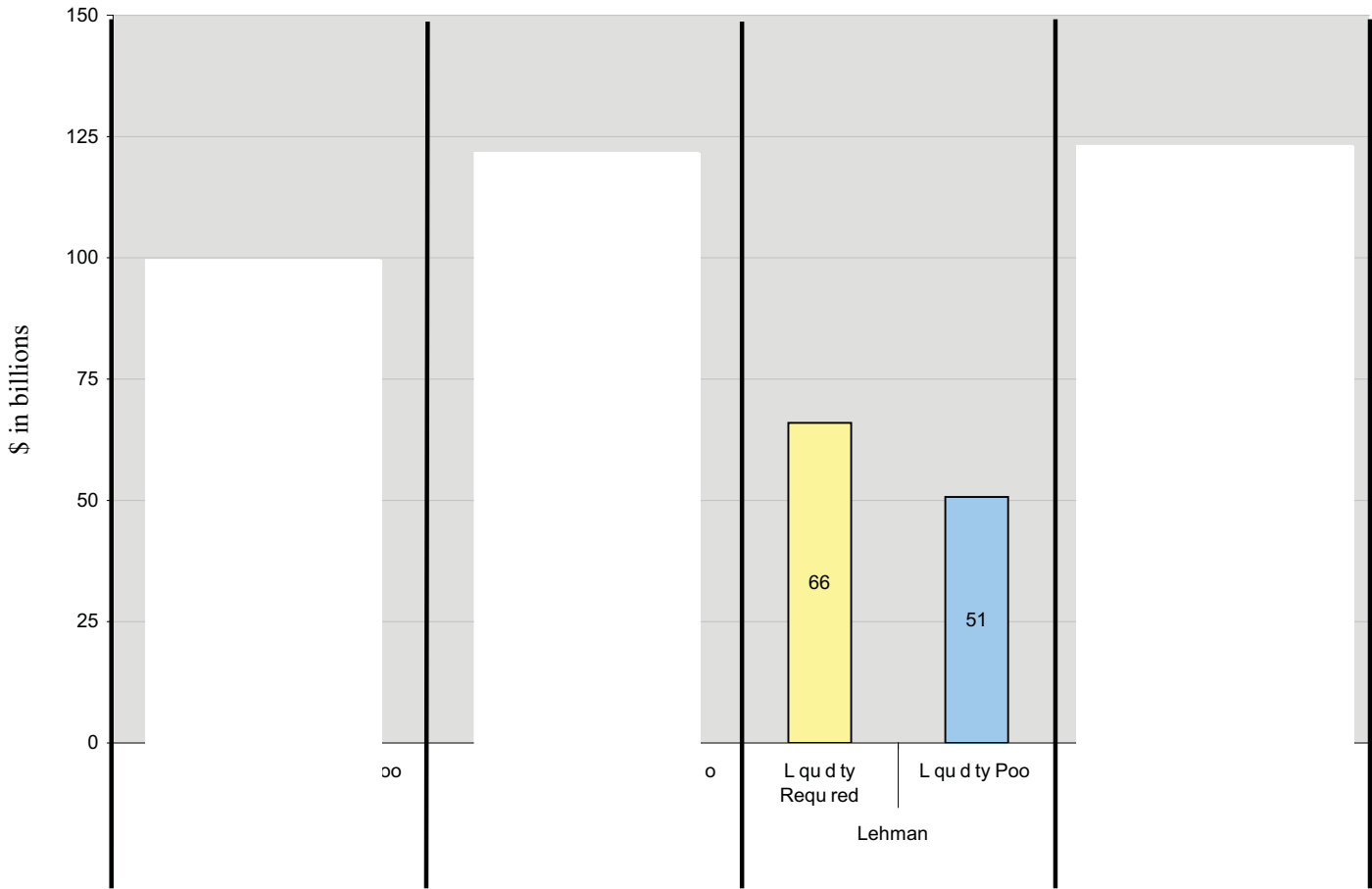
Strictly Confidential

Liquidity Stress Analysis: Assumptions

<i>As of dates: 5/22/08 - 6/10/08</i>	Severity Assumption
UNSECURED FUNDING - Percent not rolling	
Total Unsecured Funding	100%
SECURED FUNDING - Percent not rolling	
Fixed Income Finance	
OMO Eligible	0%
Liquid	20%
Less Liquid	50%
Illiquid	100%
Equity Finance	
Liquid	20%
Less Liquid	50%
ON-BOARDING AND OTHER COMMITMENTS	
Off-Balance Sheet Assets On-Boarded	Institution Specific
Loan Commitments/Other Contractual Uses	Institution Specific
Other Liabilities/Commitments	Institution Specific
OPERATING CASH FLOWS	
Prime Brokerage, Withdrawal of Free Credits	50%
Prime Brokerage, Customer Shorts with Liquidity Risk	11%
Prime Brokerage, Release of Lockup Cash Flows	90% - 100%
Collateral Payments	Institution Specific
Derivatives / Margin Mismatches: Payments / Receipts	100% / 90%
ADDITIONAL FUNDING	
Affiliated and Unaffiliated Bank Lines	Institution Specific

Summary of Results

			Lehman	
Liquidity Sources as % of Liquidity Required			78%	
Cushion / (Deficit) \$ <i>in billions</i>			(15)	



Detailed Cash Flows

<i>Exhibit produced 6/23/08</i>					
<i>\$ in billions, 4 Week Horizon, As of 5/22/08 - 6/10/08</i>				Lehman	
Liquidity Outflows					
1	Unsecured Funding: amount not rolling			14	
2	Secured Funding: amount not rolling			32	
3	On-Boarding and Other Commitments			8	
4	Operating Cash Flows: net outflows (sum of lines 4a - 4c)			13	
4a	<i>Prime Brokerage</i>			2	
4b	<i>Collateral Payments</i>			9	
4c	<i>Derivatives/Margin Payment Mismatches</i>			2	
5	Liquidity Required (sum of lines 1-4)			66	
Liquidity Sources					
6	Liquidity Sources (sum of lines 6a - 6c)			51	
6a	Broker Dealer Cash (available to fund B/D outflows only)			4	
6b	Parent Liquidity Pool (unrestricted)			38	
6c	Affiliated and Unaffiliated Bank Lines			9	
7	Cushion / (Deficit)			(15)	
8	Liquidity Sources / Liquidity Required (line 6 / line 5)			78%	
9	Secured Funding Outflow / Liquidity Sources				
9a	Secured Funding Outflow / Liquidity Sources (line 2 / line 6)			62%	
9b	Discussion Point: Reduction in Secured Funding Outflow required to achieve a 33% ratio in line 9a ¹			15	
9c	% Secured Funding > 30 days ²			43%	

¹ Line 9b = line 2 - (line 6*.33)

²

Secured Funding is >14 days.

Lehman %

Observations and Conclusions

			LEHMAN	
*			<p>* Lehman's weak liquidity position is driven by its relatively large exposure to overnight CP, combined with significant overnight secured funding of less liquid assets.</p> <p>* Both one- and two-notch downgrades would result in significant collateral calls.</p> <p>* Lehman recognizes its vulnerabilities and is trying to reduce illiquid assets and extend maturities where possible. At 5/23/08, Lehman had 43% of its non-OMO eligible secured liabilities maturing beyond 14 days.</p> <p>* Lehman should improve its liquidity position by \$15 billion. Its exposure to rollover risk in non-OMO eligible secured funding represents a large draw on its liquidity sources (62%) and should be reduced by further extensions in maturity on these liabilities, sales of the underlying assets or by increasing liquidity sources to mitigate the risk.</p>	

TAB 11

From: Hoyt, Robert
Sent: Thursday, July 10, 2008 9:48 PM
To: Schaffer, Laurie
Subject: Re:

They indicated that the real problem is 70 billion of illiquid bonds, so I assume finding liquidity for them is the key.

----- Original Message -----

From: Schaffer, Laurie
To: Hoyt, Robert
Sent: Thu Jul 10 21:13:54 2008
Subject:

Bob, what issue do you think we are trying to address at lehman, liquidity or capital? I assume liquidity.

Thanks. Laurie

TAB 12

[REDACTED]

From: Hoyt, Robert
Sent: Friday, July 11, 2008 6:24 AM
To: Schaffer, Laurie
Subject: Re:

New thought: the Fed has plenty of legal authority to provide liquidity, and if they choose not to, I doubt we would. So the real question may be what authorities can we exercise in a scenario where we want to let the firm fail, but then step in to minimize effects on creditors and the system. Basically, a receivership option. Consider this -- could we negotiate a pre-packaged bankruptcy where we provide funding, operate the business, and take care of creditors? Or could we get a bankruptcy judge to appoint us to be a receiver? Perhaps via the US Trustee's office?

----- Original Message -----
From: Schaffer, Laurie
To: Hoyt, Robert
Sent: Thu Jul 10 21:13:54 2008
Subject:

Bob, what issue do you think we are trying to address at lehman, liquidity or capital? I assume liquidity.

Thanks. Laurie

TAB 13

From: [Patrick M Parkinson](#)
To: [Pat White](#)
Subject: Fw: Update on Lehman
Date: 07/11/2008 05:14 PM

Federated is one of the very largest tri-party repo investors. Pat

▼ David Marshall

----- Original Message -----

From: David Marshall
Sent: 07/11/2008 03:45 PM CDT
To: Patrick Parkinson; William Dudley; Patricia Mosser; William English
Cc: Pat White; Alejandro LaTorre
Subject: Update on Lehman

Kim Taylor sent me a follow-up e-mail. The repo lines that were pulled from Lehman were from Dreyfus and Federated. These are mid sized players, but not dealers. Kim thought that this represented an improvement to the picture.

-- David

David Marshall
Senior Vice President
Financial Markets Group
Federal Reserve Bank of Chicago
(312) 322-5102

TAB 14

From: [Kieran Fallon](#)
To: [Rich Ashton](#); [Mark VanDerWeide](#)
Subject: Fw: PDCF, Tri-party variant
Date: 07/11/2008 06:38 PM
Attachments: [Memo--loss of confidence triparty repo borrower 11July2008.doc](#)

----- Forwarded by Kieran Fallon/BOARD/FRS on 07/11/2008 06:38 PM -----

**Patrick M
Parkinson/BOARD/FRS**

To brian.f.madigan@frb.gov, Kieran
Fallon/BOARD/FRS@BOARD

cc

07/11/2008 12:51 PM

Subject Fw: PDCF, Tri-party variant

FRBNY's latest thinking about how the Fed might provide liquidity to Lehman through PDCF (or an expanded PDCF).

Pat

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 07/11/2008 12:50 PM -----

**Lucinda M
Brickler/NY/FRS@FRS**

To Patrick M Parkinson/BOARD/FRS@BOARD

cc

07/11/2008 12:19 PM

Subject Fw: PDCF, Tri-party variant

See attached below. It's not really a new plan. it's the recycled plan on how to step into the clearing bank's shoes to provide intraday credit to a dealer in the event the clearing bank is unwilling to do so.

You will likely find the third part interesting--which analyzes the current state of Lehman's triparty collateral.

Although this document refers to a conditional non-recourse loan to the bank, a 13(3) loan directly to the dealer seems to be a better idea. We are talking through collateral, margin, legal agreement, operating issues, etc., today to put together a plan in the event it becomes necessary to consider this.

Lucinda Brickler
Payments Policy Function
Federal Reserve Bank of New York
212.720.6132 or 646.720.6132

----- Forwarded by Lucinda M Brickler/NY/FRS on 07/11/2008 12:12 PM -----


**Til
Schuermann/NY/FRS**

To Chris McCurdy/NY/FRS@FRS

cc Calvin Mitchell/NY/FRS@FRS, Chris

07/11/2008 09:37 AM

McCurdy/NY/FRS@FRS, James P Bergin/NY/FRS@FRS,
Jan Voigts/NY/FRS@FRS, Joseph Tracy/NY/FRS@FRS,
Joyce Hansen/NY/FRS@FRS, Lucinda M
Brickler/NY/FRS@FRS, meg.mcconnell@ny.frb.org,
Michael Schetzel/NY/FRS@FRS, Michael
Schussler/NY/FRS@FRS, Sandy Krieger/NY/FRS@FRS,
Tanshel Pointer/NY/FRS@FRS, Terrence
Checki/NY/FRS@FRS, Timothy Geithner/NY/FRS@FRS,
William BRODOWS/NY/FRS@FRS, William
Dudley/NY/FRS@FRS, William Rutledge/NY/FRS@FRS

Subject Re: PDCF, Tri-party variant 

The attached now includes the firm-specific impact. Should have been there last night -- computer snafu.

I will bring printed copies now.

Best,

Til



Memo--loss of confidence triparty repo borrower 11July2008.doc

Til Schuermann
Research, Financial Intermediation
Federal Reserve Bank of New York
(212) 720-5968
<http://nyfedeconomists.org/schuermann/>

Any comments or statements in this message represent the views of the author only and not necessarily those of the Federal Reserve Bank of New York or the Federal Reserve System.

▼ Chris McCurdy/NY/FRS

**Chris
McCurdy/NY/FRS**

07/11/2008 08:42 AM

To Timothy Geithner/NY/FRS
cc Terrence Checki/NY/FRS@FRS, William
Rutledge/NY/FRS@FRS, William Dudley/NY/FRS@FRS,
Joseph Tracy/NY/FRS@FRS, Sandy
Krieger/NY/FRS@FRS, Calvin Mitchell/NY/FRS@FRS,
Chris McCurdy/NY/FRS@FRS, Joyce
Hansen/NY/FRS@FRS, Lucinda M
Brickler/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS,
James P Bergin/NY/FRS@FRS, William
BRODOWS/NY/FRS@FRS, meg.mcconnell@ny.frb.org,
Jan Voigts/NY/FRS@FRS, Michael
Schussler/NY/FRS@FRS, Michael
Schetzel/NY/FRS@FRS, Lucinda M Brickler/NY/FRS,
Tanshel Pointer/NY/FRS@FRS

Subject PDCF, Tri-party variant

Here is draft memo on an idea for making the PDCF more like tri-party investing. We are working on a section outlining what extensive PDCF financing would mean for Lehman.

[attachment "Memo--loss of confidence triparty repo borrower.doc" deleted by Til Schuermann/NY/FRS]

Tim Geithner
July 11, 2008

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE MEMORANDUM

DATE July 11, 2008

To Tim Geithner SUBJECT Managing a Loss of Confidence in a
FROM Brickler, Brodows, McCurdy, Schuermann Major Tri-party Repo Borrower

RESTRICTED FR

Objectives

Drawing on the current arrangement for tri-party repo financing, here is a plan for Federal Reserve financing of a dealer's positions on a 24-hour basis. Currently, a dealer's positions are financed overnight by tri-party repo investors and during the day by its clearing bank. Should a dealer lose the confidence of its investors or clearing bank, their efforts to pull away from providing credit could be disastrous for the firm and also cast widespread doubt about the instrument as a nearly risk free, liquid overnight investment. In the event a firm faced this situation the Federal Reserve could step- in and provide overnight financing as it does now through the PDCF, and by replacing the credit provided by the clearing bank during the day.

The key elements are outlined in the second section of this note. Finally, we have estimated what it would mean for Lehman Brothers, as one example, if we were to apply our conservative haircuts to the full range of their tri-party collateral.

By allowing a dealer to provide a strong face to the market, this approach is intended to support market confidence in the dealer and, by continuing the smooth functioning of the market, in the tri-party repo instrument itself. This could be done on an announced or unannounced basis. Providing an unannounced financing back-stop to the firm would permit it to face the market in a business as usual manner, seeking funds at market rates and on terms comparable to other firms. Further, the Fed's provision of funds to the clearing banks during the day would put them in the position to wire out any funds investors may request intra-day. In the midst of a stress situation the fast return

of funds would again alleviate concerns about market functioning and further boost confidence in the tri-party instrument.

Providing the facility on an announced basis--that we are willing to do this against good collateral and with strong haircuts might cause the same sort of speculation about use--but it would underscore the Fed's intention to support the instruments. Investors would still need to make their credit judgments about counterparties but they would know that they will get their money back and will not get locked in if they decide to pull back.

Proposed Action

To prevent a loss of confidence in a large tri-party repo borrower from triggering a broader loss of confidence in the tri-party repo mechanism, the Federal Reserve should strongly encourage the tri-party repo agent bank to provide intraday financing to the bank and honor investor requests for withdrawals promptly. If the borrower fails to attract sufficient financing by the end of the day, the borrower could turn to the PDCF.

If the triparty repo agent bank cannot be convinced, the Federal Reserve could consider providing the dealer with intraday credit in order to avert a widespread loss of confidence in the triparty repo mechanism.

- FRBNY could enter into a "conditional" non-recourse loan with the clearing bank at the beginning of the day, collateralized by a cash claim on the dealer in question and the associated collateral. If the dealer survives the day, the clearing bank would be required to repay the loan before the end of the day (at zero percent interest). The loan would not appear on their balance sheet or on the Federal Reserve's. The dealer could turn to the PDCF for any residual funding needed for the following night.
- If the dealer does not survive the day, the clearing bank would have the option to extinguish the loan before the end of the day by transferring their cash claim on the dealer and the associated collateral to FRBNY. (Legal analysis pending.)

- FRBNY would liquidate the dealer's collateral (potentially at a loss) in the event that the cash claim was not fulfilled. Collateral could be held in an off-balance sheet entity during the liquidation period.

Impact on Firm

To compute the financial impact, we make use of the firm's reported allocated repo collateral as per the firm's own MIS dated July 9, 2008. The total global collateral is \$297.7bn, of which \$1.5bn is Asia, \$59.8bn Europe, and \$236.5bn US. The US breakdown is summarized in Table 1 below, with totals by type indicated at the top. The firm had \$173bn or 73% of its collateral in OMO eligible, another \$39.5bn (17%) in PDCF eligible,¹ and a remaining \$23.6bn (10%) in other collateral types.

¹ All munis are assumed to be PDCF eligible, though only investment grade are. We do not know precisely what proportion of the muni portfolio is investment grade, but are told that it is the vast majority. The category "other" was left out entirely; it makes up only \$0.1bn and is thus not material.

Table 1: Lehman US repo collateral, as of July 9, 2008

Collateral Type	Exposure (bn)
OMO	173.3
PDCF	39.5
Other	23.6
Treasuries	62.0
Government Agency	28.4
Agency MBS	82.9
Asset Backs - Investment Grade	5.8
Asset Backs - Non-Investment Grade	1.5
Corporates - Investment Grade	10.4
Corporates - Non-Investment Grade	4.2
Money Markets	9.6
Muni	4.1
Other	0.1
Private Labels - Investment Grade	9.7
Private Labels - High Yield	2.0
Wholeloan Commercial	5.7
Wholeloan Residential	0.4
C1 - Investment Grade Convertibles	0.5
C2 - Non-Investment Grade Convertibles	0.8
Equities	8.5
Total	\$ 236.46

We now go on to compute the haircut impact on this portfolio of collateral. This is presented in Table 2 where we repeat the collateral amounts and add haircut information for each asset type. Two haircuts are presented. First our proposed haircuts based on conservative volatility assumptions [a brief methodology description can be found at the end of this document], and second the average haircut actually charged by JPMC in the course of its tri-party clearing operations. The latter are meant to reflect typical current haircuts experienced by the firm.

Because the portfolio is 73% OMO eligible, the weighted average haircuts are modest: 1.055 (or 5.5%) using the conservative volatilities, and 1.023 (2.3%)

using the average JPMC haircuts.² If all collateral were to be pledged – including \$23.6bn of heretofore non-PDCF eligible collateral – the firm would need to post \$13.1bn in extra cash, using our proposed conservative haircuts, to realize the full value of its collateral. Using JPMC’s average haircuts, that amount is just \$5.4bn.

² The (non-weighted) average haircut of PDCF eligible collateral is about 1.079, or 7.9%.

Table 2: Lehman US repo collateral, as of July 9, 2008, including haircut considerations

Collateral Type	Exposure (\$bn)	Conservative	Average	Collateral Requirement (bn)	
		Volatility	JPMC HC	Conservative	Avg
Treasuries	62.0	1.015	1.01	\$ 62.94	\$ 62.63
Government Agency	28.4	1.02	1.01	\$ 28.97	\$ 28.69
Agency MBS	82.9	1.05	1.02	\$ 87.07	\$ 84.59
Asset Backs - Investment Grade	5.8	1.15	1.03	\$ 6.66	\$ 5.94
Asset Backs - Non-I-Grade	1.5	1.25	1.15	\$ 1.82	\$ 1.67
Corporates - Investment Grade	10.4	1.05	1.01	\$ 10.87	\$ 10.47
Corporates - Non-Investment Grade	4.2	1.10	1.05	\$ 4.67	\$ 4.46
Money Markets	9.6	1.05	1.01	\$ 10.03	\$ 9.65
Muni	4.1	1.10	1.05	\$ 4.48	\$ 4.28
Other	0.1	1.05	1.02	\$ 0.08	\$ 0.07
Private Labels - Investment Grade	9.7	1.15	1.05	\$ 11.16	\$ 10.19
Private Labels - High Yield	2.0	1.25	1.10	\$ 2.55	\$ 2.24
Wholeloan Commercial	5.7	1.15	1.08	\$ 6.50	\$ 6.10
Wholeloan Residential	0.4	1.15	1.08	\$ 0.49	\$ 0.46
C1 - Investment Grade Convertibles	0.5	1.15	1.08	\$ 0.58	\$ 0.54
C2 - Non-I-Grade Convertibles	0.8	1.20	1.12	\$ 0.90	\$ 0.84
Equities	8.5	1.15	1.08	\$ 9.77	\$ 9.18
Total	\$ 236.46	1.055	1.023	\$ 249.54	\$ 242.00
<i>cash equivalent</i>				\$ 224.06	\$ 231.04
<i>extra collateral</i>				\$ 13.08	\$ 5.54

Conservative Haircut Methodology

The principle behind the haircuts is a scaled dynamic volatility measure. For each of the major tri-party asset classes, we chose 2 risk factor time series, usually indices available on Bloomberg. One was the major or most representative index (say for municipals, the Merrill Muni Master), or a more adversely selected index (for munis, Merrill's Muni Misc 12-22 yrs series). The latter would likely be more appropriate since if and when an institution would pledge a security at the PDCF, it will probably be one of the less liquid securities for a given asset type or class.

Using daily returns from the indices, we compute a dynamic volatility using the RiskMetrics exponentially weighted moving average model. We then have a time series of daily volatilities. Some of the time series are quite long (10+yrs), others shorter (<2 yrs for some of the more esoteric series). We then take the 99th percentile from the time series of volatilities as a measure of an unusually large volatility. This may have occurred recently, eg. in March for some of the structured credit products, or in the more distant past, an example here being the fall of 1998 for the corporate credit master index. This daily volatility is then scaled to a monthly horizon via the square-root of t (here $t=21$ days) rule. The volatilities are then grouped into three initial haircut buckets: 2%, 5%, and 10%. Treasuries have a haircut of 1.5%, commensurate with the standard tri-party repo haircut. It seems reasonable to keep this haircut the same as Treasuries, though they may be volatile as well, are likely to improve in value during turbulent times ("good volatility").

Finally we make an adjustment based on the shape of the volatility distribution itself. Volatility is but one way of measuring risk. If the volatility itself is subject to sudden moves and jumps, which tends to happen in the more illiquid instruments, then this is an added risk. Thus, the more skewed the distribution of volatility, the more volatility surprises one may experience, the more risky the asset class.

Our final haircuts range from 2% (1.5% for Treasuries) to 25% (ABS speculative grade).

TAB 15

From: [Joseph Sommer](#)
To: [Jamie McAndrews](#); [Meg McConnell](#); [Lucinda M Brickler](#)
Cc: [Antoine Martin](#); [Arthur Angulo](#); [Brian Begalle](#); [Catherine Kung](#); [Chris McCurdy](#); [HaeRan Kim](#); [Jan Voigts](#); [Lawrence Sweet](#); [Michael Schussler](#); [Morten Bech](#); [Patrick M Parkinson](#); [Sandy Krieger](#); [Terrence Checki](#); [Thomas Baxter](#); [Til Schuermann](#); [William BRODOWS](#); [William Dudley](#)
Subject: Re: another option we should present re triparty?
Date: 07/13/2008 08:50 AM

I agree with your analysis, but I don't endorse the word "permanent.". The question is whether the government wishes to get into the private equity business--not whether the government wishes to get into the investment banking business.

Your mileage may vary, but the question is one of PE.

Sent from my BlackBerry Handheld.

▼ [Jamie McAndrews](#)

----- Original Message -----

From: Jamie McAndrews
Sent: 07/12/2008 09:46 PM EDT
To: Meg McConnell; Lucinda Brickler
Cc: Antoine Martin; Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jan Voigts; Joseph Sommer; Lawrence Sweet; Michael Schussler; Morten Bech; Patrick Parkinson; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley
Subject: Re: another option we should present re triparty?

Woops;

Antoine makes the following point:

"The question we should ask is: In hindsight, is there anything we would do differently in the case of BS?
If we think we would do something fundamentally differently, then we should tell Tim what and why.

My impression is that we would do essentially the same thing, so there is not much to talk about for the very short-term. Of course, there is lots to do in the medium and long term."

The thing we would have to decide is whether the distressed firm was likely to be sold. If we think that the run had progressed too far and that it wouldn't be sold, then any lending we did to it would be a permanent addition to the government's balance sheet--like Northern Rock, again.

That is the crucial question at the time a decision must be made. If we think it can be sold, then proceed as in BS. If not, discuss with the Treasury its appetite for a permanent addition to the government's balance sheet by lending to the distressed firm; if there is little appetite for that, then lend to the distressed firm's creditors, and work to contain the spread of the problem with communication policy.

The difficulty of making the determination of whether we think the firm can be sold is high, especially given that the refusal of the clearing bank to unwind the repos means that a run on the firm is fait accompli.

Jamie

Sent from my BlackBerry Wireless Handheld (www.BlackBerry.net)

▼ Meg McConnell

----- Original Message -----

From: Meg McConnell

Sent: 07/12/2008 09:07 PM EDT

To: Lucinda Brickler

Cc: Antoine Martin; Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jamie McAndrews; Jan Voigts; Joseph Sommer; Lawrence Sweet; Michael Schussler; Morten Bech; Patrick Parkinson; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley

Subject: Re: another option we should present re triparty?

I guess I'm not sure about the analogy to the BSC situation. In that case we were lending to JPMC on a nonrecourse basis, but we weren't doing so because they were BSC's clearing bank, but rather because they intended to purchase BSC, and thus ultimately stand behind all of BSC's obligations--tri-party or otherwise. And as Michael pointed out, the "beauty" (in the legal sense of the word) of the LLC was that we could lend to the LLC and the LLC could buy from BSC the assets that JPMC would not. I'm wondering whether without a buyer for LEH in the picture, what the end game is for the scenario you describe below (i.e., what is this a bridge to, given that there is no one in the wings waiting to buy LEH's assets and stand behind the remainder of their liabilities?). Do you see what I mean or am I missing something?

▼ Lucinda M Brickler/NY/FRS

**Lucinda M
Brickler/NY/FRS**

07/12/2008 06:22 PM

To Chris.McCurdy@ny.frb.org, Patrick M Parkinson/BOARD/FRS@BOARD, Sandy.Krieger@ny.frb.org, Lawrence.Sweet@ny.frb.org, Arthur Angulo/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Morten Bech/NY/FRS@FRS, Antoine Martin/NY/FRS@FRS, Michael Schussler/NY/FRS@FRS, Joseph Sommer/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS, Catherine Kung/NY/FRS@FRS, Brian Begalle/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, William Dudley/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS

cc

Subject another option we should present re triparty?

Perhaps another option we could offer Tim on triparty...

If JPMC refuses to unwind LB's triparty one morning out of fear of being caught with the entirety of this exposure when the music stops, by that evening they (and we) will likely have a much bigger problem to deal with as scores of investors pull away from triparty repo.

Instead of merely offering to take all of the risk to LB on our shoulders by stepping in as the intraday creditor (as the current proposal suggests), perhaps we just need to offer JPMC an outcome that is slightly more palatable.

We could encourage them to unwind and tell them that if LB fails on their watch, we will facilitate off balance liquidation support for some or all of the assets (a la Bear). (The mechanics of this are hazy, but one way would be to enter into the dreaded non-recourse loan with JPMC against the assets in question. They can pay back the loan by handing us the collateral. The legal community doesn't like this because it smells not so much like a loan, but an outright purchase of assets. I'm not sure what authority we used to purchase the Bear assets.)

We would apply our conservative margins on the assets--to reduce the likelihood that FRBNY will experience a loss, but capping the clearing bank's losses at a level that is more palatable outcome than if they use their nuclear option. (As Jamie McAndrews and his team have pointed out, there must be some value that this business brings that them would make some level of losses to preserve it tenable.)

Could we offset the sting of margins that would protect us from loss with giving them notes in the liquidation vehicle that would entitle them to any profits made on the sale of the assets allowing them the possibility of recovering some of their losses (a la Checki-LEC?)

This has the advantage of containing the problem without taking on the whole potential for losses. Allows the clearing bank to see light at the end of a tunnel of the default of a \$236 billion exposure.

This is an idea Chris hatched back in May. Our writeup from that time is attached. Let me know your thoughts...

Lucinda
[attachment "FRBNY Liquidation Facility 5-23.doc" deleted by Meg McConnell/NY/FRS]]

Lucinda Brickler
Payments Policy Function
Federal Reserve Bank of New York
212.720.6132 or 646.720.6132

TAB 16

From: [Joseph Sommer](#)
To: [Patrick M Parkinson](#)
Subject: Re: another option we should present re triparty?
Date: 07/13/2008 12:39 PM

I agree, if you are willing to fund the firm indefinitely, and maybe enter the private equity business. The question, in my mind, is whether we will be perceived as a credible investor by counterparties and employees. If so, the only question is going-concern value

Sent from my BlackBerry Handheld.

▼ [Patrick M Parkinson](#)

----- Original Message -----

From: Patrick M Parkinson
Sent: 07/13/2008 12:35 PM EDT
To: Joseph Sommer
Cc: Antoine Martin; Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jamie McAndrews; Jan Voigts; Lawrence Sweet; Lucinda Brickler; Meg McConnell; Michael Schussler; Morten Bech; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley

Subject: Re: another option we should present re triparty?

But the point of our PDCF lending would be to head off a massive run. Perhaps in a world where "headline risk" is an important concern a run would still occur. But if so we would end up lending at the end of the day an amount that still would be no higher (and could be far smaller) than what others seem to want to commit to lend at the beginning of the day. I assume that our judgment that an institution is sound refers to its going concern value, not its fire sale value.

Pat

▼ [Joseph Sommer/NY/FRS@FRS](#)

**Joseph
Sommer/NY/FRS@FRS**

07/13/2008 11:21 AM

To William BRODOWS/NY/FRS@FRS, Antoine Martin/NY/FRS@FRS, Patrick M Parkinson/BOARD/FRS@BOARD, Lucinda M Brickler/NY/FRS@FRS

cc Arthur Angulo/NY/FRS@FRS, Brian Begalle/NY/FRS@FRS, Catherine Kung/NY/FRS@FRS, Chris McCurdy/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, Lawrence Sweet/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS, Michael Schussler/NY/FRS@FRS, Morten Bech/NY/FRS@FRS, Sandy Krieger/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, William Dudley/NY/FRS@FRS

Subject Re: another option we should present re triparty? 

I only wish. Balance-sheet capital isn't too relevant if you're suffering a

massive run. And capital is the difference between two large numbers-- sensitive to asset value fluctuations.
I suppose this is where we come in. If we indeed do come in.

Sent from my BlackBerry Handheld.

▼ William BRODOWS

----- Original Message -----

From: William BRODOWS
Sent: 07/13/2008 11:19 AM EDT
To: Antoine Martin; Patrick Parkinson; Lucinda Brickler
Cc: Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jamie McAndrews; Jan Voigts; Joseph Sommer; Lawrence Sweet; Meg McConnell; Michael Schussler; Morten Bech; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William Dudley
Subject: Re: another option we should present re triparty?
Given that lehman has 32 billion in capital (which is also in liquid form), there are few scenarios over the next few weeks in which one could contemplate an intra-day determination that they would become bankrupt.

Sent from my BlackBerry Handheld.

▼ Antoine Martin

----- Original Message -----

From: Antoine Martin
Sent: 07/13/2008 10:07 AM EDT
To: Patrick Parkinson; Lucinda Brickler
Cc: Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jamie McAndrews; Jan Voigts; Joseph Sommer; Lawrence Sweet; Meg McConnell; Michael Schussler; Morten Bech; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley
Subject: Re: another option we should present re triparty?
JPMC should be willing to unwind as long as we can commit to lend at the PDCF. If we cannot commit, they may be worried that by the end of the day, we would judge that LB is not solvent and then we could not use the PDCF.

Of course, in that case we would do something else to rescue LB, but the negotiating position of JPMC would be much weaker than in the morning, before they unwind.

Antoine

Sent from my BlackBerry Wireless Handheld

▼ Patrick M Parkinson

----- Original Message -----

From: Patrick M Parkinson
Sent: 07/13/2008 09:21 AM EDT
To: Lucinda Brickler
Cc: Antoine Martin; Arthur Angulo; Brian Begalle; Catherine Kung; Chris McCurdy; HaeRan Kim; Jamie McAndrews; Jan Voigts; Joseph Sommer; Lawrence Sweet; Meg McConnell; Michael Schussler; Morten Bech; Sandy Krieger; Terrence Checki; Thomas Baxter; Til Schuermann; William BRODOWS; William Dudley
Subject: Re: another option we should present re triparty?
I think this option is much too complex. To answer a question others

have asked, the biggest difference between today and when Bear lost access to financing is that the PDCF is in place. As long as we judge that LB is sound we should be willing to lend to it through the PDCF at conservative haircuts (as previously envisioned). With the PDCF in place there is no need to use JPMC as an intermediary.

And we should tell JPMC that with the PDCF in place refusing to unwind is unnecessary and would be unforgivable. It is unnecessary because even if JPMC is right that LB will have trouble rolling its repos with private counterparties we will provide the credit necessary to obviate any credit extensions to LB by JPMC. Failing to unwind would be unforgivable because it would force us to immediately lend an amount equal to the entire amount of LB's outstanding tri-party financing when private parties may be willing to continue to fund a significant portion, especially after we demonstrate that they are not vulnerable to a run because of our willingness to lend.

Pat

▼ Lucinda M Brickler/NY/FRS@FRS

**Lucinda M
Brickler/NY/FRS@FRS**

07/12/2008 06:20 PM

To Chris.McCurdy@ny.frb.org, Patrick M Parkinson/BOARD/FRS@BOARD, Sandy.Krieger@ny.frb.org, Lawrence.Sweet@ny.frb.org, Arthur Angulo/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Morten Bech/NY/FRS@FRS, Antoine Martin/NY/FRS@FRS, Michael Schussler/NY/FRS@FRS, Joseph Sommer/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS, Catherine Kung/NY/FRS@FRS, Brian Begalle/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, William Dudley/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS

cc

Subject another option we should present re triparty?

Perhaps another option we could offer Tim on triparty...

If JPMC refuses to unwind LB's triparty one morning out of fear of being caught with the entirety of this exposure when the music stops, by that evening they (and we) will likely have a much bigger problem to deal with as scores of investors pull away from triparty repo.

Instead of merely offering to take all of the risk to LB on our shoulders by stepping in as the intraday creditor (as the current proposal suggests), perhaps we just need to offer JPMC an outcome that is slightly more palatable.

TAB 17

From: [Scott Alvarez](#)
To: [Kieran Fallon](#)
Subject: Re: Lehman Good Bank/Bad Bank idea discussed last night
Date: 07/15/2008 09:46 AM

Good
Thanks
Scott

Sent from my BlackBerry Wireless Handheld

▼ [Kieran Fallon](#)

----- Original Message -----

From: Kieran Fallon
Sent: 07/15/2008 09:39 AM EDT
To: Scott Alvarez; Rich Ashton; Mark VanDerWeide
Subject: Fw: Lehman Good Bank/Bad Bank idea discussed last night

See scenario that New York is shopping for dealing with Lehman. Differences between proposal and Bear: no buyer in the wings for Lehman, Lehman would have \$5B in equity in LLC formed to take bad assets, Fed gets EQUITY in the "good Lehman."

Pat said that Kohn did not push back very hard on this proposal on call last night. I told Pat that I would raise significant concerns with proposal on the 10 am call this morning.

Kieran

----- Forwarded by Kieran Fallon/BOARD/FRS on 07/15/2008 09:34 AM -----

**Patrick M
Parkinson/BOARD/FRS**

To	Kieran Fallon/BOARD/FRS@BOARD
cc	
07/15/2008 09:29 AM	Subject Fw: Lehman Good Bank/Bad Bank idea discussed last night

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 07/15/2008 09:28 AM -----

**William
Dudley/NY/FRS@FRS**

To	chris.mccurdy@ny.frb.org, donald.l.kohn@frb.gov, Kevin Warsh/BOARD/FRS@BOARD, lucinda.brickler@ny.frb.org, Meg McConnell/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, timothy.geithner@ny.frb.org, Patrick M Parkinson/BOARD/FRS@BOARD
cc	Michael Schetzel/NY/FRS@FRS
07/15/2008 08:15 AM	Subject Lehman Good Bank/Bad Bank idea discussed last night

Just to put some words to what I was proposing last night. Very much

in the spirit of what we did with Bear...but better because less damage to franchise, no forced sale.

Lehman Good Bank/Bad Bank proposal

All the numbers are rough guesses, but I want to give you an explicit example to think about.

Separate into two parts:

Maiden Lane type vehicle: \$60 billion of illiquid assets backstopped by \$5 billion of Lehman equity. Fed guarantees financing or finances the \$55 billion. Lehman owns this vehicle, so if assets > liabilities upon windup, accrue to Lehman shareholders.

Clean Lehman left. \$600 billion of assets, \$23 billion of equity. Much less risk, greater liquidity cushion (don't have to finance illiquid assets).

Fed gets equity in clean Lehman (whether warrants or some other form of equity TBD in compensation for backstop financing in SPV).

Protections to the Fed. First loss piece, net interest margin on SPV, and equity in clean Lehman.

Why we want to do this. Takes illiquid assets off the market, reduces risk that forced sale of assets will generate losses that make Lehman insolvent. Preserve Lehman franchise value as a going concern. No negative externality to rest of financial system. Moral hazard considerations low given equity dilution. Clean Lehman can be sold or remain a viable concern.

Risks:

Other firms will want to do the same thing.

Response: Can set the level of dilution high to make this less attractive. For example, if the Fed was given warrants giving it effectively 50% or more of the upside in Lehman going forward, this would deter others from pursuing this unless in extremis.

Why would Lehman do this?

Better than forced asset sales. Preserves franchise. No need for distressed sale of the entire company. Can find a medium-term solution.

If Lehman is solvent now, this preserve solvency. If Lehman is, in fact, insolvent now--even in the absence of forced asset sales--this limits degree of insolvency. Risk of not intervening early, Lehman is solvent now, becomes insolvent due to forced asset sales. Benefits of forced sale of firm under duress accrue to buyer, and large negative externalities to the broader market.

We could propose it to Lehman as a choice. Does not have to be coercive. If slide were to continue, what might have looked unattractive might increasing look attractive relative to the alternatives.

Best,
Bill

TAB 18

on@frb.gov

07/20/2008 12:42
PM

Chairman Bernanke

To

Kevin.Warsh@frb.gov,
scott.alvarez@frb.gov,
brian.f.madigan@frb.gov

cc

Subject
Our Options in the Event of a Run
on LB

The short answer is the one that Tim gave to the FOMC on Wednesday: There are no good options.

Here is my version of the long answer.

Focusing for the moment on LB's vulnerable tri-party borrowings, as of July 14 it was financing \$200 billion of collateral. Of that amount, all but \$12.8 billion was PDCF-eligible. Of the non-PDCF-eligible, \$8.7 billion was equities.

JPMC, LB's clearing bank, is likely to be the first to realize that the money funds and other investors that provide tri-party financing to LB are pulling back significantly. If some morning it fears that the investors are unlikely to roll their repos, it may threaten not to unwind LB's previous night's repos. If it did that, LB would be done because the tri-party investors would control its securities inventory. The investors presumably would promptly liquidate the \$200 billion of collateral and there is a good chance that investors would lose confidence in the tri-party mechanism and pull back from funding other dealers. Fear of those consequences is, of course, why we facilitated Bear's acquisition by JPMC.

We could try to dissuade JPMC from refusing to unwind by pointing out that if the investors don't roll the repos LB can borrow from us through the PDCF. Even if we did so, for two reasons JPMC might still balk. The first is the non-PDCF collateral. We could address that concern by making the equities and other non-PDCF collateral eligible. Or we could try to get LB to wire \$12.8 billion of cash into JPMC to cover the rollover risk. The other reason is a fear that LB could be placed in bankruptcy intra-day, before the next day's tri-party repos and any PDCF loans are settled, in which case JPMC would be stuck with \$200 billion in secured loans to LB. I'm not sure that this is at all likely, but JPMC and BNYM are sufficiently concerned that they have arranged a meeting Monday afternoon with SIPC. (LB's PD is a SIPC member (as are some but not all of the other PDs) and its bankruptcy would be administered by SIPC.) Board staff plan to sit in on this meeting.

But even if we are willing to extend as much as \$200 billion of financing to LB, absent an acquirer our action would not ensure LB's survival. If stigma associated with PDCF borrowing is justified, LB likely would face other (non-tri-party) liquidity demands and I'm not sure whether its liquidity resources would allow it to meet them. (Presumably our PD supervisory team has a better idea but any judgment is likely to be qualified.) So we would have protected LB's tri-party counterparties but not its other counterparties (e.g., securities (mainly equities) borrowers and lenders and derivatives counterparties). Further, the demonstration of our willingness to lend large amounts through PDCF may not reassure tri-party investors that the mechanism is safe, especially if they start asking about our remaining capacity to meet further runs. That's not to imply that it would not be worth the gamble, but it would be a gamble.

Pat

TAB 19

From: [Patrick M Parkinson](#)
To: steven.shafran@do.treas.gov
Cc: [William BRODOWS](#); Arthur.Angulo@ny.frb.org; [Theodore Lubke](#); [Til Schuermann](#)
Subject: Fw: Gameplan and Status to Date
Date: 08/19/2008 12:19 PM

Steve,

See below. We keep coming up against the same quandary that we have discussed previously. I still think it is worth engaging the industry group, even though that is not without risks. We could cast it simply as CRMPG III follow-up on issues of long-standing interest to public sector as well as the private sector. At the same time, we could quietly drill down deeper at LB and perhaps at some other dealer that is not under a cloud, both to see the extent to which different business models present different problems and to be able to truthfully tell LB that they are not the sole source of concern, as they shouldn't be.

On the substance, the interesting question is whether it would be possible to stabilize the legal entity where most of an IB's OTC derivatives trades are booked. One potential problem is that defaults by affiliates would allow counterparties to terminate trades with the legal entity that we seek to stabilize. Cross default provisions presumably could allow counterparties to terminate trades with the legal entity. If so, how readily could the legal entity reestablish its hedges, even if the government recapitalized it or guaranteed its obligations? Another potential problem is that the legal entity may have large exposures to affiliates that are going under. Notwithstanding these potential problems, I think the place to start is with an understanding of the legal entities positions, hedges, and counterparty exposures.

As to timing, Both Bill and I (and many others) are on vacation this week.


Reactions?

Pat

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 08/19/2008 11:56 AM -----

**William
BRODOWS/NY/FRS@FRS**

08/15/2008 06:11 PM

To: Patrick M Parkinson/BOARD/FRS@BOARD
cc: Arthur.Angulo@ny.frb.org, Theodore
Lubke/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS
Subject: Re: Fw: Gameplan and Status to Date 

Pat--we met with Lehman two days ago and have a draft of notes that have not been agreed upon. In any event, I don't think we really got much new information that will push the agenda forward. My initial takeaway is that legal entity will drive the analysis and that aggregation of counterparties across legal entities will be the next level of analysis. As HaeRan indicated, to really get into possibilities, you would need to request master agreements which I believe would be a huge negative signal, and I would be very reluctant to take that step. In this connection, merely having the meeting with Lehman caused a stir in Lehman and we had to assure them that our questions were not institution specific, even as I noted that we did

not have any other meetings yet scheduled with other institutions. Fortunately, there was an industry meeting on the subject the next day that indicated a broad interest in the subject. We were very careful to limit the meeting to 60 minutes. I would be very reluctant to drill deeper at Lehman at this point without a clear signal that our work involved other institutions in some way. Asking for the industry group (your suggestion) would seem to me to be less provocative than gathering info from a single firm. However, I certainly can see the point that asking for the industry group could spook the market, but going to a single firm is even less desirable in my view. Sorry I can't be more helpful than this. Going on vacation next week, but will check for your emails. Cheers.

▼ Patrick M Parkinson/BOARD/FRS@BOARD

**Patrick M
Parkinson/BOARD/FRS@BOARD**

08/15/2008 02:02 PM

To Arthur.Angulo@ny.frb.org, Theodore
Lubke/NY/FRS@FRS, Til
Schuermann/NY/FRS@FRS, William
BRODOWS/NY/FRS@FRS

cc

Subject Fw: Gameplan and Status to Date

See below. I worry that without gathering more info we will not come up with a sensible gameplan.

How are you coming with info gathering from Lehman?

Pat

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 08/15/2008 01:56 PM -----

Steven.Shafran@do.treas.gov

08/11/2008 03:04 PM

To Patrick.M.Parkinson@frb.gov

cc

Subject RE: Gameplan and Status to Date

My worry is that while this would make sense in a less stressed market, that the timing right now is problematic. If we ask, will we see anything in time to deal with some of the immediate issues that concern us? And by asking, are we signaling concerns that only exacerbate the issues?

My concern is we need a gameplan for a specific problem that we could be confronted with at any time.

steve

-----Original Message-----

From: Patrick.M.Parkinson@frb.gov [mailto:Patrick.M.Parkinson@frb.gov]

Sent: Friday, August 08, 2008 4:02 PM

To: Shafran, Steven

Cc: Arthur.Angulo@ny.frb.org; haeran.kim@ny.frb.org; Schaffer, Laurie;
lucinda.brickler@ny.frb.org; Broome, Meredith;
Theodore.Lubke@ny.frb.org; Til.Schuermann@ny.frb.org;
William.BRODOWS@ny.frb.org; Patrick.M.Parkinson@frb.gov
Subject: Re: Gameplan and Status to Date

I have been plowing through the CRMPG III (Corrigan III) report. Recommendation V-22 (p. 125) states that the industry should consider formation of a "default management group", composed of senior business representatives of major market participants (from the buy-side as well as the sell-side) to work with regulatory authorities on an ongoing basis to consider and anticipate issues likely to arise in the event of a default of a major counterparty.

Would it be worth asking Corrigan to accelerate formation of this group and ask them what they see as the issues? We would of course need to be careful not to suggest concerns about any particular market participant, although they no doubt would draw their own conclusions.

Pat

	Patrick M	
	Parkinson/BOARD/F	
	RS	
To		steven.shafran@do.treas.gov
	08/08/2008 09:47	
cc	AM	Arthur.Angulo@ny.frb.org, haeran.kim@ny.frb.org, laurie.schaffer@do.treas.gov, lucinda.brickler@ny.frb.org, Theodore Lubke/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, Patrick M Parkinson/BOARD/FRS@BOARD, Meredith.Broome@do.treas.gov
Subject		Gameplan and Status to Date (Document link: Patrick M Parkinson)

Here is how I see the gameplan. Comments are welcome.

1. Identify activities of the firm whose liquidation under Chapter 11 could have a significant adverse effect on financial markets and the economy.
2. Gather additional information about those activities so as to assess more accurately the potential for liquidation to have such an effect.
3. Where we conclude the potential is serious, identify actions that the firm, its counterparties or the government could take to mitigate the risk.
With respect to government actions, consider both actions that could be taken under existing authority as well actions that would require legislative authorization.
4. Our preliminary view is that the principal investment bank activities that could entail systemic risk are tri-party repo borrowings and OTC derivatives activities. But we need to ask again whether they may be other such activities, including sec borrow/loan.
5. We have given considerable thought to what might be done to avoid a fire sale of tri-party repo collateral. (That said, the options under existing authority are not very attractive--lots of risk to Fed/taxpayer, lots of moral hazard.) We still are at the early stages of assessing the potential systemic risk from close-out of OTC derivatives transactions by an investment bank's counterparties and identifying potential mitigants.

Pat

Patrick M

Parkinson/BOARD/F

RS

To

steven.shafran@do.treas.gov,

08/08/2008 09:15

laurie.schaffer@do.treas.gov

AM

cc

Arthur.Angulo@ny.frb.org,

lucinda.brickler@ny.frb.org,

William BRODOWS/NY/FRS@FRS,

haeran.kim@ny.frb.org, Theodore

Lubke/NY/FRS@FRS, Til

Schuermann/NY/FRS@FRS, Patrick M

Parkinson/BOARD/FRS@BOARD

Subject

Conference Call Participants

Are copied on this message.

Pat

TAB 20

Kevin Coffey/NY/FRS

08/14/2008 10:47 PM

To

Terrence Checki/NY/FRS@FRS, William Rutledge/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS

cc

Christopher Calabia/NY/FRS, Elise Liebers/NY/FRS@FRS

bcc

Subject

AIG - Meeting with OTS

Elise and I met with the OTS's AIG team on August 11 for a long sought meeting to open a dialogue with them about AIG and its operations as well as to discuss some of the insurance related issues we have seen w/r/t the monoline financial guarantors that may similarly impact firms such as AIG. Overall, the meeting was successful and we agreed to meet again in the near future to continue to exchange views etc.. The OTS team was very open, sharing their views on AIG's operations, OTS's oversight program etc.. They also seemed genuinely appreciative to hear our thoughts on issues relating to CDS counterparties, the monolines and various other issues that have come up at banks over the past year (e.g., GIC triggers, liquidity puts, secured funding rollover risk) that could affect similar firm's liquidity and capital etc..and how we assess some of the potential impact (e.g., waterfalls).

As it was an introductory meeting, we did not want to push the team too specifically or deep in some area but we hope to gain more information in our future discussions so I apologize upfront if details are missing or contradictions are evident.

Capital Raise & Liquidity Management

- OTS confirmed that the primary reason for the \$20 billion capital raise in May was for liquidity purposes. Since that time, approximately \$6-7 billion has been used to support AIGFP (via repos) and another \$1 billion was infused directly into AIG SunAmerica to support its growth. Given the remaining \$12-13 billion, they seemed generally comfortable with the firm's current liquidity. They were also confident that the firm could

access the capital markets with no problem if it had to. From a capital standpoint, AIG now has \$3-5 billion in "excess capital" down from \$15-20 billion.

- Until six or seven months ago, liquidity management was not a holding company activity and things were managed in "fiefdoms" (i.e., AIGFP, Domestic Life, ILFC etc). The firm is now implementing common stress testing across major businesses and is also starting to require the businesses to run liquidity scenario analysis where there is no external financing for 1 year. (We tried to clarify if this meant no unsecured borrowings and/or no secured borrowings and they seemed to indicate it covered both but this will need to be clarified in the future).

- From a securities lending standpoint, things are currently better and they indicated that cash and short-term investments had risen to about \$20 billion recently. They also indicated that tenors on these deals ranged from overnight out to six months but were not sure whether there had been any change/shortening in the maturity profile of the book, although they had the numbers (and may discuss further). Finally, they viewed the securities being lent as scarce, in demand by borrowers and therefore less likely to have funding rollover issues.

(Note: CSG's CPC team indicated today that in its relationship with AIG, CSG does not need the securities it borrows but instead AIG is using the deals to raise cash. As such, CSG is looking to take a haircut on AIG's securities as opposed to posting cash to AIG in excess of the securities value which is the market standard).

- In order to expand liquidity capacity, the firm's insurance companies were setting up repo lines which they had never done before (it was unclear if this had already been implemented or if it is on the to do list). They are also setting up another \$2 billion inter-company LOC.

Recent Rating Agency Statements

- The team had not yet had an opportunity to review the Moodys or the S&P statements on AIG so they had not yet factored this into their analysis (or earlier comments on liquidity and capital). However, they seemed to focus particular attention when we mentioned the S&P statement regarding AIG's need to achieve earnings stability in the third quarter. As they noted a quite a few times, this gave AIG only 45 days.

AIGFP specific issues

- CEO Bob Willumstad is under significant pressure to exit this business (given the CDS losses).

- The firm has about a \$100 b balance sheet and is assigned proxy/rating agency capital of about \$2 billion in the OTS's capital regime. As such, capital requirements for this business (as well as ILFC) may be subject to changing rating agency capital standards.

- The Commission Bancaire may be pressuring Banque AIG (AIG's main European derivatives company facing clients who then enters into an offsetting deal with AIGFP) to reduce exposure with AIGFP given its size. OTS is looking to do more work on the European operations of AIG in the near future.

=====

=====

Please let Elise or I know if you have any question etc. w/r/t the above.

Kevin D. Coffey, CFA
Financial Sector Policy and Analysis
Federal Reserve Bank of New York
kevin.coffey@ny.frb.org
212-720-1719

TAB 21

AIG – Summary of Drivers of Potential Earnings, Capital and Liquidity Issues¹
August 14, 2008

Despite raising \$20 billion of capital in May 2008, AIG is under increasing capital and liquidity pressure. The firm appears to need to raise substantial longer term funds to address the impact of deteriorating asset values on its capital and available liquidity as well as to address certain asset/liability funding mismatches. This could require the firm to issue additional debt and equity; re-position assets on its balance sheet via asset sales to increase its liquidity; and/or to further access secured funding markets via repurchase agreements, to the extent permissible.

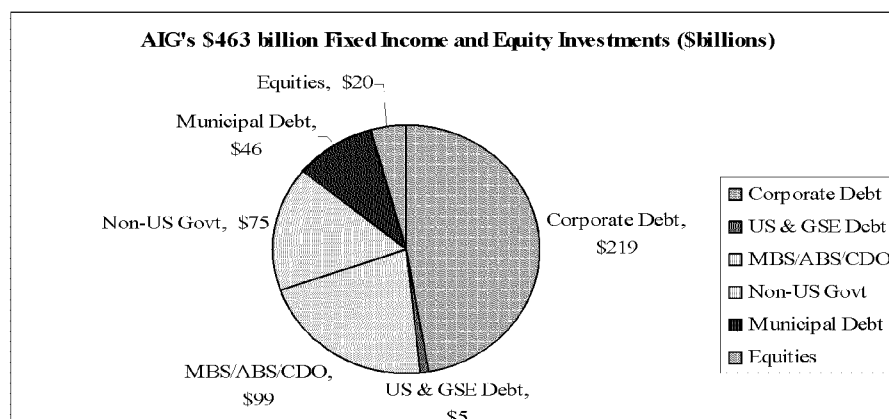
Moodys and S&P highlighted earning, capital and/or liquidity concerns following AIG's Q2 earnings announcement last week.

- Moodys reiterated its negative outlook for AIG and expressed its expectation that the firm will actively address its capital and liquidity needs. Moodys also stated that the failure of AIG to address these concerns in the near term could lead to a downgrade of AIG and/or some of its operating units.
- S&P, while expressing concerns about certain of AIG's asset/liability mismatches, warned that a downgrade of one notch would be likely if earnings at AIG did not stabilize in the current quarter.

Given the current environment, it appears the firm needs to move aggressively to address these challenges or face additional ratings downgrades, further liquidity drains, and potentially increasing investor/counterparty uncertainty that could further exacerbate its situation.

Based on internal analysis, there are six areas driving the current earnings, capital and/or liquidity issues for AIG:

1. Fixed Income and equity investments of the firm (primarily in AIG's domestic life insurance cos.) are heavily weighted to structured credit products (20%) that have experienced significant valuation losses and have reduced earnings and capital as impairments have been recognized. These and other asset can be further impacted as/if conditions continue to deteriorate.



¹ For further information or details, please contact Kevin Coffey, FRBNY, at 212-720-1719.

2. Unfunded synthetic credit assets – predominantly \$80 billion of multi-sector super-senior CDO credit protection sold by AIGFP– are also experiencing significant mark-to-market losses. Because many of these CDS contracts provide for margin calls to cover losses, significant cash out flows have occurred since the beginning of the year and the firm is subject to ongoing margin calls as/if conditions continue to deteriorate.
 - To date, the firm’s multi-sector CDOs have recorded losses of \$26.5 billion. Against these positions, the firm has posted \$16.5 billion of collateral with counterparties (of which an estimated \$13 billion has been posted since the beginning of this year).
3. The firm has significant amounts of near term liabilities including GICs maturing in less than one year (\$11 billion), funding obtained via short term securities lending agreements (\$75 billion) and current portions of the firm’s long-term debt that may impact its liquidity needs.
 - Through its securities lending agreements, AIG has borrowed \$75 billion. These funds have generally been invested in longer term credit assets – RMBS/ABS/ CDOs (\$36b), corporate bonds (13b), cash (10b) – that have lost approximately \$16 billion². Because the maturities of the securities lending contracts range from 1 day (approximately \$7 billion) out to 6 months, the firm is subject to significant rollover risk on these liabilities to the extent redemptions exceed available cash and proceeds from asset sales. In addition, the assets (and the firm’s insurance entities) can be further impacted as/if conditions continue to deteriorate.
4. The firm has other commitments to purchase CDOs that could require funding.
 - The firm has \$10.5 billion of commitments to purchase super-senior CDOs via Liquidity Puts (i.e., 2(a)7 puts) and to purchase super-senior CDOs if certain event of default triggers are hit in CDOs. As of July 31, \$1.6 billion of these transactions have already experienced event of default triggers, with only \$100 million funded. The firm has committed liquidity lines of \$3 billion available to support purchases of specific (but not all) deals within this portfolio.
 - In addition, the firm has various additional commitments of \$17 billion (e.g., private equity, hedge funds and limited partnership calls).
5. The firm has ratings-based triggers in various GIC and derivatives contracts that could result in significant collateral calls if it is downgraded a single notch by either Moodys or S&P.
 - A one notch downgrade by Moodys or S&P could expose the firm to collateral calls of \$15 billion. If both rating agencies were to lower their ratings one notch, this outflow would potentially increase to \$18 billion.
6. The firm has limited standby credit facilities available to manage sudden cash needs.
 - Although the firm has third party revolving credit facilities of \$18 billion, approximately \$14 billion is currently utilized³. The remaining \$ 4 billion of facilities are meant to support the firm’s commercial paper programs but are also available for broader corporate purposes.⁴

² These assets are not included as part of the firm’s fixed income and equity investments cited in point 1.

³ AIG has an additional \$5 billion of undrawn facility where subsidiaries of the company are the lenders.

⁴ It is unclear from the firm’s disclosures if the \$3 billion of committed liquidity lines related to the Liquidity Puts are included in this amount.

TAB 22

From: Patrick.M.Parkinson@frb.gov
Sent: Tuesday, August 19, 2008 12:19 PM
To: Shafran, Steven
Cc: William.BRODOWS@ny.frb.org; Arthur.Angulo@ny.frb.org; Theodore.Lubke@ny.frb.org; Til.Schuermann@ny.frb.org
Subject: Fw: Gameplan and Status to Date

Steve,

See below. We keep coming up against the same quandary that we have discussed previously. I still think it is worth engaging the industry group, even though that is not without risks. We could cast it simply as CRMPG III follow-up on issues of long-standing interest to public sector as well as the private sector. At the same time, we could quietly drill down deeper at LB and perhaps at some other dealer that is not under a cloud, both to see the extent to which different business models present different problems and to be able to truthfully tell LB that they are not the sole source of concern, as they shouldn't be.

On the substance, the interesting question is whether it would be possible to stabilize the legal entity where most of an IB's OTC derivatives trades are booked. One potential problem is that defaults by affiliates would allow counterparties to terminate trades with the legal entity that we seek to stabilize. Cross default provisions presumably could allow counterparties to terminate trades with the legal entity. If so, how readily could the legal entity reestablish its hedges, even if the government recapitalized it or guaranteed its obligations? Another potential problem is that the legal entity may have large exposures to affiliates that are going under. Notwithstanding these potential problems, I think the place to start is with an understanding of the legal entities positions, hedges, and counterparty exposures.

As to timing, Both Bill and I (and many others) are on vacation this week.

Reactions?

Pat

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 08/19/2008 11:56 AM -----

William
BRODOWS/NY/FRS@FR
S

08/15/2008 06:11
PM

To
Patrick M Parkinson/BOARD/FRS@BOARD
cc
Arthur.Angulo@ny.frb.org, Theodore
Lubke/NY/FRS@FRS, Til
Schuermann/NY/FRS@FRS

Subject
Re: Fw: Gameplan and Status to Date
(Document link: Patrick M
Parkinson)

Pat--we met with Lehman two days ago and have a draft of notes that have not been agreed upon. In any event, I don't think we really got much new information that will push the agenda forward. My initial takeaway is that legal entity will drive the analysis and that aggregation of counterparties across legal entities will be the next level of analysis. As HaeRan indicated, to really get into possibilities, you would need to request master agreements which I believe would be a huge negative signal, and I would be very reluctant to take that step. In this connection, merely having the meeting with Lehman caused a stir in Lehman and we had to assure them that our questions were not institution specific, even as I noted that we did not have any other meetings yet scheduled with other institutions. Fortunately, there was an industry meeting on the subject the next day that indicated a broad interest in the subject. We were very careful to limit the meeting to 60 minutes. I would be very reluctant to drill deeper at Lehman at this point without a clear signal that our work involved other institutions in some way. Asking for the industry group (your suggestion) would seem to me to be less provocative than gathering info from a single firm. However, I certainly can see the point that asking for the industry group could spook the market, but going to a single firm is even less desirable in my view. Sorry I can't be more helpful than this. Going on vacation next week, but will check for your emails. Cheers.

Patrick M
Parkinson/BOARD/F
RS@BOARD

08/15/2008 02:02
PM

To
Arthur.Angulo@ny.frb.org, Theodore
Lubke/NY/FRS@FRS, Til
Schuermann/NY/FRS@FRS, William
BRODOWS/NY/FRS@FRS

cc

Subject
Fw: Gameplan and Status to Date

See below. I worry that without gathering more info we will not come up with a sensible gameplan.

How are you coming with info gathering from Lehman?

Pat

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 08/15/2008 01:56 PM

Steven.Shafran@do
.treas.gov

08/11/2008 03:04
PM

Patrick.M.Parkinson@frb.gov

To

cc

Subject

RE: Gameplan and Status to Date

My worry is that while this would make sense in a less stressed market, that the timing right now is problematic. If we ask, will we see anything in time to deal with some of the immediate issues that concern us? And by asking, are we signaling concerns that only exacerbate the issues?

My concern is we need a gameplan for a specific problem that we could be confronted with at any time.

steve

-----Original Message-----

From: Patrick.M.Parkinson@frb.gov [mailto:Patrick.M.Parkinson@frb.gov]

Sent: Friday, August 08, 2008 4:02 PM

To: Shafran, Steven

Cc: Arthur.Angulo@ny.frb.org; haeran.kim@ny.frb.org; Schaffer, Laurie;
lucinda.brickler@ny.frb.org; Broome, Meredith; Theodore.Lubke@ny.frb.org;

Til.Schuermann@ny.frb.org; William.BRODOWS@ny.frb.org; Patrick.M.Parkinson@frb.gov

Subject: Re: Gameplan and Status to Date

I have been plowing through the CRMPG III (Corrigan III) report. Recommendation V-22 (p. 125) states that the industry should consider formation of a "default management group", composed of senior business representatives of major market participants (from the buy-side as well as the sell-side) to work with regulatory authorities on an ongoing basis to consider and anticipate issues likely to arise in the event of a default of a major counterparty.

Would it be worth asking Corrigan to accelerate formation of this group and ask them what they see as the issues? We would of course need to be careful not to suggest concerns about any particular market participant, although they no doubt would draw their own conclusions.

Pat

Patrick M

Parkinson/BOARD/F

RS
To steven.shafraan@do.treas.gov
08/08/2008 09:47
cc AM Arthur.Angulo@ny.frb.org,
haeran.kim@ny.frb.org,
laurie.schaffer [REDACTED]
lucinda.brickler@ny.frb.org,
Theodore Lubke/NY/FRS@FRS, Til
Schuermann/NY/FRS@FRS, William
BRODOWS/NY/FRS@FRS, Patrick M
Parkinson/BOARD/FRS@BOARD,
Meredith.Broome [REDACTED]
Subject Gameplan and Status to Date
(Document link: Patrick M
Parkinson)

Here is how I see the gameplan. Comments are welcome.

1. Identify activities of the firm whose liquidation under Chapter 11 could have a significant adverse effect on financial markets and the economy.
2. Gather additional information about those activities so as to assess more accurately the potential for liquidation to have such an effect.
3. Where we conclude the potential is serious, identify actions that the firm, its counterparties or the government could take to mitigate the risk.

With respect to government actions, consider both actions that could be taken under existing authority as well actions that would require legislative authorization.

4. Our preliminary view is that the principal investment bank activities that could entail systemic risk are tri-party repo borrowings and OTC derivatives activities. But we need to ask again whether they may be other such activities, including sec borrow/loan.

5. We have given considerable thought to what might be done to avoid a fire sale of tri-party repo collateral. (That said, the options under existing authority are not very attractive-- lots of risk to Fed/taxpayer, lots of moral hazard.) We still are at the early stages of assessing the potential systemic risk from close-out of OTC derivatives transactions by an investment bank's counterparties and identifying potential mitigants.

Pat

Patrick M

Parkinson/BOARD/F

RS

To

steven.shafraan@do.treas.gov,

08/08/2008 09:15

laurie.schaffer [REDACTED]

AM

cc

Arthur.Angulo@ny.frb.org,

lucinda.brickler@ny.frb.org,

William BRODOWS/NY/FRS@FRS,

haeran.kim@ny.frb.org, Theodore

Lubke/NY/FRS@FRS, Til

Schuermann/NY/FRS@FRS, Patrick M

Parkinson/BOARD/FRS@BOARD

Subject

Conference Call Participants

Are copied on this message.

Pat

TAB 23

From: [Patrick M Parkinson](#)
To: steven.shafran@do.treas.gov
Cc: [William BRODOWS](#); Arthur.Angulo@ny.frb.org; [Theodore Lubke](#); [Til Schuermann](#)
Subject: Fw: Gameplan and Status to Date
Date: 08/19/2008 12:19 PM

Steve,

See below. We keep coming up against the same quandary that we have discussed previously. I still think it is worth engaging the industry group, even though that is not without risks. We could cast it simply as CRMPG III follow-up on issues of long-standing interest to public sector as well as the private sector. At the same time, we could quietly drill down deeper at LB and perhaps at some other dealer that is not under a cloud, both to see the extent to which different business models present different problems and to be able to truthfully tell LB that they are not the sole source of concern, as they shouldn't be.

On the substance, the interesting question is whether it would be possible to stabilize the legal entity where most of an IB's OTC derivatives trades are booked. One potential problem is that defaults by affiliates would allow counterparties to terminate trades with the legal entity that we seek to stabilize. Cross default provisions presumably could allow counterparties to terminate trades with the legal entity. If so, how readily could the legal entity reestablish its hedges, even if the government recapitalized it or guaranteed its obligations? Another potential problem is that the legal entity may have large exposures to affiliates that are going under. Notwithstanding these potential problems, I think the place to start is with an understanding of the legal entities positions, hedges, and counterparty exposures.

As to timing, Both Bill and I (and many others) are on vacation this week.


Reactions?

Pat

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 08/19/2008 11:56 AM -----

**William
BRODOWS/NY/FRS@FRS**

08/15/2008 06:11 PM

To: Patrick M Parkinson/BOARD/FRS@BOARD
cc: Arthur.Angulo@ny.frb.org, Theodore Lubke/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS
Subject: Re: Fw: Gameplan and Status to Date 

Pat--we met with Lehman two days ago and have a draft of notes that have not been agreed upon. In any event, I don't think we really got much new information that will push the agenda forward. My initial takeaway is that legal entity will drive the analysis and that aggregation of counterparties across legal entities will be the next level of analysis. As HaeRan indicated, to really get into possibilities, you would need to request master agreements which I believe would be a huge negative signal, and I would be very reluctant to take that step. In this connection, merely having the meeting with Lehman caused a stir in Lehman and we had to assure them that our questions were not institution specific, even as I noted that we did

not have any other meetings yet scheduled with other institutions. Fortunately, there was an industry meeting on the subject the next day that indicated a broad interest in the subject. We were very careful to limit the meeting to 60 minutes. I would be very reluctant to drill deeper at Lehman at this point without a clear signal that our work involved other institutions in some way. Asking for the industry group (your suggestion) would seem to me to be less provocative than gathering info from a single firm. However, I certainly can see the point that asking for the industry group could spook the market, but going to a single firm is even less desirable in my view. Sorry I can't be more helpful than this. Going on vacation next week, but will check for your emails. Cheers.

▼ Patrick M Parkinson/BOARD/FRS@BOARD

**Patrick M
Parkinson/BOARD/FRS@BOARD**

08/15/2008 02:02 PM

To Arthur.Angulo@ny.frb.org, Theodore
Lubke/NY/FRS@FRS, Til
Schuermann/NY/FRS@FRS, William
BRODOWS/NY/FRS@FRS

cc

Subject Fw: Gameplan and Status to Date

See below. I worry that without gathering more info we will not come up with a sensible gameplan.

How are you coming with info gathering from Lehman?

Pat

----- Forwarded by Patrick M Parkinson/BOARD/FRS on 08/15/2008 01:56 PM -----

Steven.Shafran@do.treas.gov

08/11/2008 03:04 PM

To Patrick.M.Parkinson@frb.gov

cc

Subject RE: Gameplan and Status to Date

My worry is that while this would make sense in a less stressed market, that the timing right now is problematic. If we ask, will we see anything in time to deal with some of the immediate issues that concern us? And by asking, are we signaling concerns that only exacerbate the issues?

My concern is we need a gameplan for a specific problem that we could be confronted with at any time.

steve

-----Original Message-----

From: Patrick.M.Parkinson@frb.gov [mailto:Patrick.M.Parkinson@frb.gov]
Sent: Friday, August 08, 2008 4:02 PM
To: Shafran, Steven

TAB 24

AIG Liquidity and Access to the PDCF
Danielle Vicente September 2, 2008

AIG's current liquidity position is precarious and asset liability management appears inadequate given the firm's substantial off balance sheet liquidity needs. Although the insurance company has a large securities portfolio, which totals \$835 billion, liquidating sufficient assets to fund their liabilities would result in substantial realized losses and potentially impact market prices. Borrowing through the Primary Dealer Credit Facility could potentially allow AIG to unwind its positions in an orderly manner while satisfying its immediate liquidity demands, although it is questionable whether such a facility is necessary for the survival of the firm.

Volatile funding

AIG is vulnerable to "runs" on a portion of its liabilities. This funding is generally susceptible to run-off risk; risk that these liabilities would not be rolled over. Although they total nearly \$100 billion, these liabilities represent less than 10% of assets. As of second quarter 2008, volatile funding consists of:

- repurchase transactions- \$9.7 billion
- securities lending- \$75 billion
- commercial paper and extendable notes- \$15 billion

Off-balance sheet commitments

The primary concern for the insurance company's liquidity position is not volatile funding but rather its off-balance sheet commitments. Unlike liabilities on-balance sheet, the effect of these commitments on the firm's liquidity can be difficult to forecast. In the near term, possible commitments that could strain liquidity are:

- Collateral calls in the event of a downgrade – minimum of \$10.5 billion
- Contract terminations in the event of a downgrade- minimum of \$4.6 billion
- Put options exercised but not yet funded- \$1.5 billion
- Other commitments (such as private equity, ect.)- \$17 billion

These commitments that could require funding at any moment, and if events trigger margin calls and contract terminations, it is less likely that the volatile funding will be rolled over.

Other noteworthy aspects of their liquidity

Additionally, the following short term liabilities come due within the next year:

- Guaranteed investment contracts- \$9.4 billion
- Current portion of long term debt- \$28 billion

AIG has available \$4 billion in revolving credit facilities. However, it is unclear whether \$3 billion has already been designated to support put options.

What are the main concerns of AIG's current liquidity position?

Liability runs: not just a banking problem

AIG is an active securities lender; the firm takes a large portion of its securities and lends them to institutions and investors who pledge collateral against these securities. AIG then takes the collateral and invests it in assets with longer durations in order to earn a spread. This is possible because the liabilities due to the investors are normally rolled over. Currently, AIG's assets associated with securities lending are experiencing losses, and are valued at \$59.5, less than the \$75.1 billion in liabilities.

Potential liquidity need: Securities lending contracts range in maturity from one day to six months. Given the current operating environment, roll over risk is substantial, and could mirror a run on deposits. Therefore, AIG's potential overnight liquidity needs for securities lending varies, but is limited to \$75 billion.

Collateral calls: in the long run, we're all dead

AIG sold \$80 billion of multi-sector CDO protection (notional). The ultimate economic losses on the book are difficult to determine at this time. Both independent analysts and AIG's management have continually increased their estimates, however, management doubts the current estimated losses will materialize. Nevertheless, as unrealized losses grow, margin calls will require the firm to post additional collateral. This CDS book has recorded losses of \$26.1 billion to date and AIG has posted \$16.5 billion of collateral.

If the firm is downgraded by one notch by a single rating agency, collateral postings of \$10.5 billion would be required for Guaranteed Investment Agreements and other financial derivatives. The collateral call would increase to \$13.3 billion both S&P and Moody's downgrade AIG.¹

Potential liquidity need: Margin calls on this CDS book can create an immediate funding need that requires AIG to sell assets under duress.

Contract terminations: downgrades hinder liquidity

If the firm is downgraded by one notch by a single rating agency, \$4.6 billion of the CDS written on multi-sector CDOs would be terminated. Terminations would increase to \$ 5.4 billion if both agencies downgrade AIG.

The settlement of these CDSs contracts would imply a full cash outflow. Goldman's equity report points out that protection written on CDOs are often settled physically; meaning that AIG would actually purchase these debt securities at par. So a contract with

¹These estimates were calculated before Fitch announced its review of AIG's ratings. If all three agencies downgrade the firm, the collateral calls and contract terminations will increase.

a \$100 loss may imply a cash outflow of \$1000 to purchase the security, now valued at \$900 on the market.

Additionally, AIG has \$8.2 billion of CDS contracts that require the firm to maintain a certain level of over-collateralization. Should the firm not comply with these provisions, the contracts would also be terminated.

Potential liquidity need: Contract settlements on this CDS book imply a large cash outflow when combined with the margin calls.

Commitments that could come back to bite them

AIG sold \$11.3 billion of put options that may require the firm to buy CDOs backed by CMBS and hold them from three to six years. The firm has committed liquidity lines of \$3 billion to support some of these options, but of the \$1.6 billion that have experienced default triggers, only \$100 million has been funded and the remaining \$1.5 billion. The unrealized loss in the second quarter in this portfolio is \$800 million.

Potential liquidity need: In addition to the \$1.5 billion in unfunded options that have been exercised, cash will be needed to support the remaining unexercized options.

What are the perspectives of the ratings agencies?

All three major rating agencies have placed AIG on watch for downgrades. S&P is not focused on liquidity concerns as of yet, but rather earnings volatility. They seem to delay any action until the third quarter, in hopes that management will find some way to deal with the potential losses and poor operating performance of the subsidiaries. Moody's expects that management will "actively address potential liquidity and capital needs." Fitch was the last of the agencies to put the firm under review.

In general, rating methodologies for insurance firms have not incorporated analysis of liquidity in the way we analyze bank liquidity. Insurance company liquidity considerations have been focused on cash flow ratios, total investments, committed bank lines, leverage and interest coverage.

Market sentiment believes the rating agencies will require more capital of AIG to maintain its current ratings, especially as the firm is expected to make additional contributions to some subsidiaries. At year end 2006, S&P believed financial leverage would remain around 20% or less. Today, financial leverage stands at 32.4%. The firm's capital structure was 81% equity in 2007 and is now less than 70% equity due to hybrid instruments.

How do analysts see AIG?

Market sentiment is against buying credit or equity related to AIG. Review reports by Goldman, Lehman, Citigroup, and, analysts seem concerned with the extent of losses in the CDS and investment portfolios, rating agency actions on the firm, and the subsequent impacts on capital. Additionally, they worry about downgrades on AAA MBS assets that are currently benefiting from subordination, and the consequences it will have on AIG subsidiaries.

Goldman was especially concerned over liquidity. Their analyst believes AIG management and rating agencies are denial about the extent of economic losses that is expected and hint that management is not prepared to deal with the magnitude of challenges facing the firm.

TAB 25

Lehman Triparty Summary for week of 9/2-9/5

Lehman's total triparty book ranged from \$149 – 151 billion during the week of 9/2. The majority of collateral was Treasury and Agency Debt (approximately \$100 billion each day).

Approximately \$20 billion of collateral financed each day is **NOT** PDCF-eligible. This collateral is noninvestment grade and had the following breakdown on 9/5:

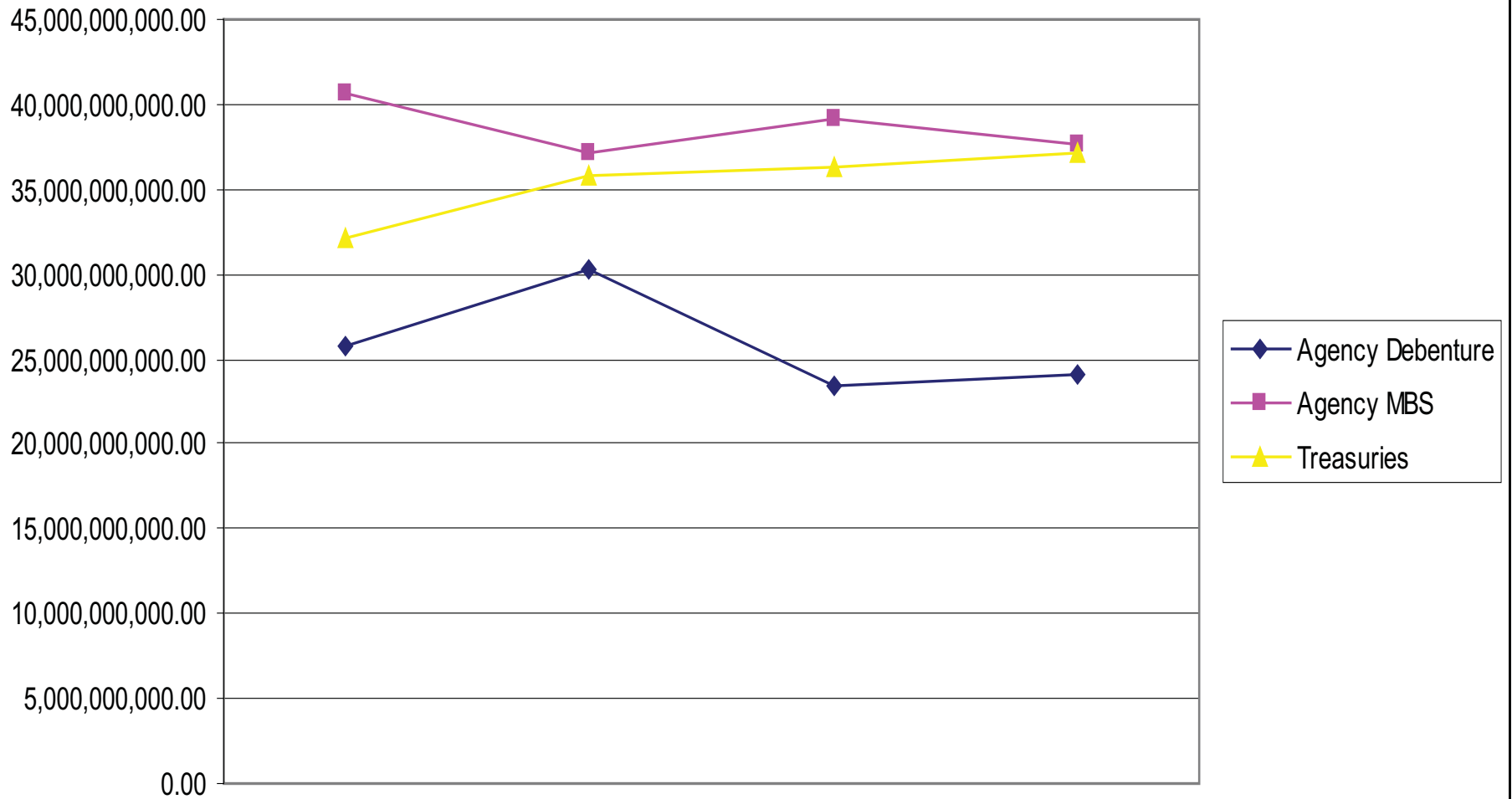
\$9.0 billion in Equities
\$4.4 billion in Corporate Bonds
\$3.8 billion in CP
\$1.6 billion in ABS
\$1.5 billion in Municipal Bonds
\$300,000 in Private Label CMO

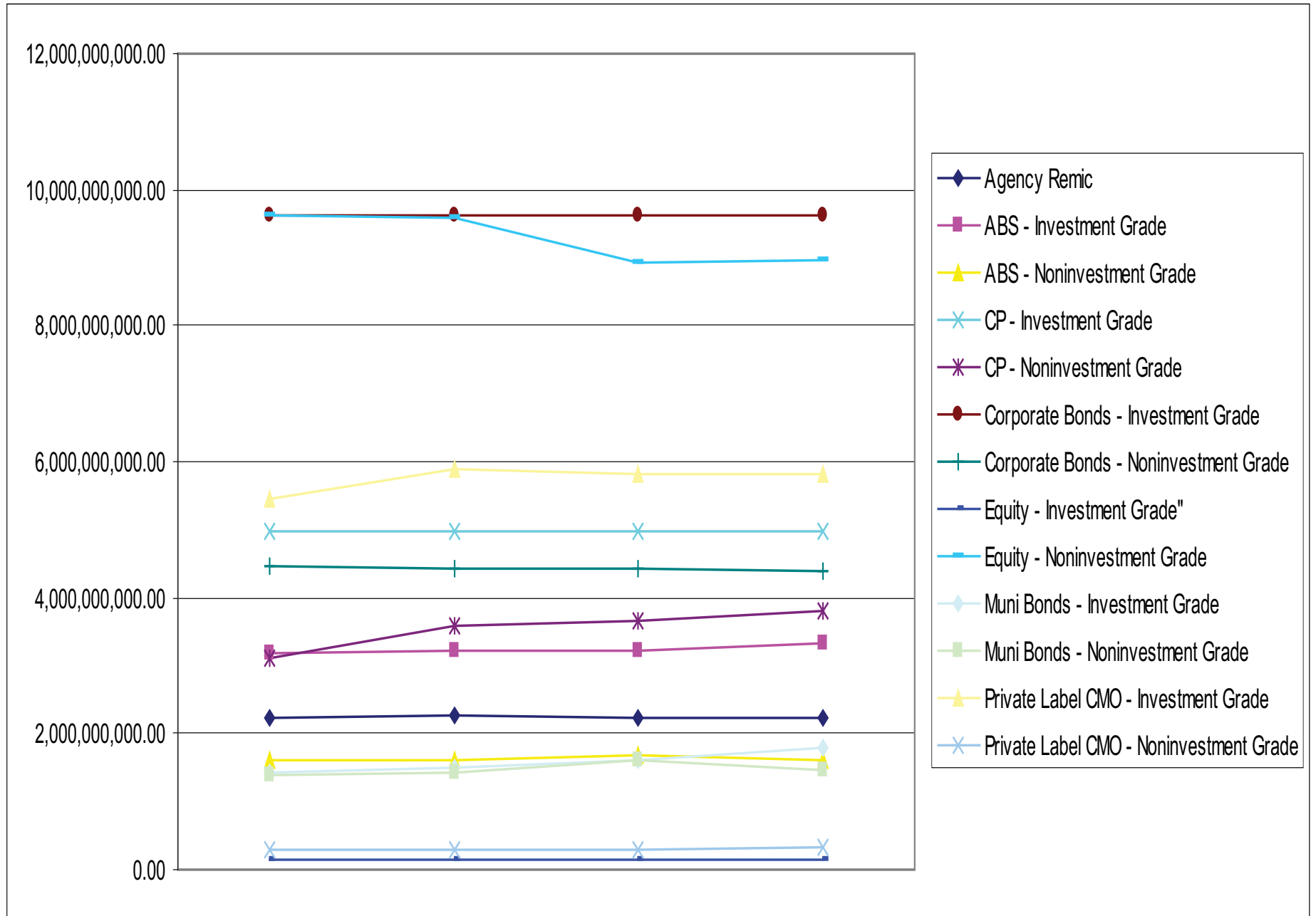
The following table shows the breakdown of the entire book on 9/5:

Asset Class	Market Value	Investment Grade
Agency MBS	\$ 37,635,274,288.68	Investment Grade
US Treasuries and Strips	\$ 37,150,876,381.27	Investment Grade
Agency Debenture	\$ 24,115,937,583.22	Investment Grade
Corporate Bonds	\$ 9,605,027,603.20	Investment Grade
Equity	\$ 8,972,375,258.96	Non-Investment Grade
Private Label CMO	\$ 5,813,030,575.22	Investment Grade
Commercial Paper	\$ 4,984,088,772.37	Investment Grade
Corporate Bonds	\$ 4,383,194,254.41	Non-Investment Grade
Commercial Paper	\$ 3,797,977,443.34	Non-Investment Grade
Asset Backed Securities	\$ 3,313,509,111.42	Investment Grade
Agency Remic	\$ 2,245,488,150.01	Investment Grade
Ginnie Mae MBS Pools	\$ 2,092,985,107.76	Investment Grade
Municipal Bonds	\$ 1,787,313,109.47	Investment Grade
Asset Backed Securities	\$ 1,608,021,237.69	Non-Investment Grade
Municipal Bonds	\$ 1,451,264,391.98	Non-Investment Grade
Ginnie Mae REMICs	\$ 589,785,121.61	Investment Grade
DTC-Other	\$ 548,992,978.64	Investment Grade
Private Label CMO	\$ 322,386,919.57	Non-Investment Grade
DTC-Other	\$ 167,029,227.35	Non-Investment Grade
Equity	\$ 146,394,627.18	Investment Grade
Other	\$ 14,235,460.81	N/A

The following charts show the breakdown of the book for the week of 9/2.

Lehman Agency and Treasury Triparty Repo





TAB 26

From: [Patrick M Parkinson](#)
To: [Theodore Lubke](#)
Subject: Draft Email to Shafran re Contingency Planning re OTC Derivatives
Date: 09/05/2008 01:50 PM
Attachments: [Info Request for OTC Derivatives_Sep 4 2008.doc](#)

Theo,

Please review and comment asap on the message below.

Thanks.

Pat

Steve,

We have discussed this matter with President Geithner and are planning to move forward promptly on several fronts.

1. We are going to make the attached request to Lehman Brothers for information regarding their OTC derivatives positions. Tim will call Dick Fuld soon to inform him of the request prior to its delivery.



Info Request for OTC Derivatives_Sep 4 2008.doc

2. With respect to other OTC derivatives dealers, there is an existing Federal reserve project that has been at six BHCs' MIS with respect to counterparty credit risk management, with a focus on OTC derivatives. To date this project has focused on metrics that are relevant to the banks as going concerns rather metrics that would be relevant to assessing the potential risks from their failure or options for mitigating those risks. Further, it has not covered the IBs. Nonetheless, we believe that it would be better to expand this existing project rather than initiate a separate but related project. Expanding the project may take some time, but we need some time to sharpen our information requests related to a failure scenario.

3. Tim will ask Corrigan to accelerate formation of the private-sector default management group (DMG) that was proposed by CRMPG III. Specifically, we will ask the group to advise us on: (1) the information that we would need to obtain from a troubled dealer to assess the potential impact of closeout of a dealer's OTC derivatives books on its counterparties and on financial markets; and (2) the information that a potential acquirer of a troubled dealer's OTC derivatives book (and possibly also related hedges) to assess the potential risks and returns from such an acquisition. The group's advice (and what we learn in the course of inquiries at Lehman) would inform the next steps in the MIS project and ultimately what our expectations will be with respect to dealer MIS.

4. Last (but not least), Theo Lubke and I have been asked to work with you to create the "playbook" for an IB failure that the Secretary has been asking for. We see it having at least three segments, corresponding to what we see as the areas of greatest concern: (1) its tri-party repos and other secured financing, (2) its OTC

derivatives book, and (3) its obligations to various clearing entities (FICC, NSCC, DTC, CME, OCC, etc.) and the risks to those entities in the event that it does not meet those obligations. Tim would like us to complete a draft of the playbook by Sep. 15 when LB, MS, and GS will be reporting their earnings.

Please let me know asap if they seems reasonable to you (other than the Sep. 15 deadline for project #4!). Also, I assume that we will want to involve SEC in preparation of the playbook. Please let me know if Treasury wants to take the lead in drawing the SEC in or whether you want us to do that.

Pat

▼ Steven.Shafran@do.treas.gov

Steven.Shafran@do.treas.gov

08/28/2008 04:54 PM

To Patrick.M.Parkinson@frb.gov

cc

Subject RE: treasury draft

Thanks for the quick response.

I had a brief chat w Paulson yesterday, and the view here (consistent w yours) is that it is imp't for us to continue to push ahead to collect the information we need in the short term for contingency planning purposes. Can confirm that his preference is to do this in a way that minimizes disruption or concerns. Indicating that we are working in spirit of Corrigan recommendations and with more than one institution seems a good idea.

Im here tomorrow. Have a good weekend and lets talk Tuesday when you back. Looking forward to de-brief on the fed staff/ny staff OTC analysis.

Steve

-----Original Message-----

From: Patrick.M.Parkinson@frb.gov [mailto:Patrick.M.Parkinson@frb.gov]

Sent: Thursday, August 28, 2008 4:34 PM

To: Shafran, Steven

Subject: Re: treasury draft

Steve,

Thanks. No, I will not be in the office tomorrow. I have circulated this to a small group of Fed (NY and DC) staff and will discuss with them next week.

Fed staff had a long discussion of the OTC derivatives issues today. New York staff will seek some guidance from Geithner tomorrow. I related your view that if we are going to approach individual firms we should do so at the top. Whatever we do with individual firms, we are inclined to encourage Corrigan to move ahead promptly with his initiative. But we don't see that as a substitute for gathering some info from individual firms in the very near term.

Pat

Steven.Shafran@do
.treas.gov

To 08/28/2008 04:11 Patrick.M.Parkinson@frb.gov

cc PM

Subject treasury draft

Pat: attached is a draft of the working product over here. Looking forward to comparing notes between this effort and yours. I think the teams were working together and hope we haven't drifted too far apart. Will you be in on Friday?

steve

<<systemicallycriticallegis draft ls.7.29.doc>> (See attached file: systemicallycriticallegis draft ls.7.29.doc)

TAB 27



To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

September 7, 2008
hp-1129

Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers

Washington, DC-- Good morning. I'm joined here by Jim Lockhart, Director of the new independent regulator, the Federal Housing Finance Agency, FHFA.

In July, Congress granted the Treasury, the Federal Reserve and FHFA new authorities with respect to the GSEs, Fannie Mae and Freddie Mac. Since that time, we have closely monitored financial market and business conditions and have analyzed in great detail the current financial condition of the GSEs – including the ability of the GSEs to weather a variety of market conditions going forward. As a result of this work, we have determined that it is necessary to take action.

Since this difficult period for the GSEs began, I have clearly stated three critical objectives: providing stability to financial markets, supporting the availability of mortgage finance, and protecting taxpayers – both by minimizing the near term costs to the taxpayer and by setting policymakers on a course to resolve the systemic risk created by the inherent conflict in the GSE structure.

Based on what we have learned about these institutions over the last four weeks – including what we learned about their capital requirements – and given the condition of financial markets today, I concluded that it would not have been in the best interest of the taxpayers for Treasury to simply make an equity investment in these enterprises in their current form.

The four steps we are announcing today are the result of detailed and thorough collaboration between FHFA, the U.S. Treasury, and the Federal Reserve.

We examined all options available, and determined that this comprehensive and complementary set of actions best meets our three objectives of market stability, mortgage availability and taxpayer protection.

Throughout this process we have been in close communication with the GSEs themselves. I have also consulted with Members of Congress from both parties and I appreciate their support as FHFA, the Federal Reserve and the Treasury have moved to address this difficult issue.

Before I turn to Jim to discuss the action he is taking today, let me make clear that these two institutions are unique. They operate solely in the mortgage market and are therefore more exposed than other financial institutions to the housing correction. Their statutory capital requirements are thin and poorly defined as compared to other institutions. Nothing about our actions today in any way reflects a changed view of the housing correction or of the strength of other U.S. financial institutions.

I support the Director's decision as necessary and appropriate and had advised him that conservatorship was the only form in which I would commit taxpayer money to the GSEs.

I appreciate the productive cooperation we have received from the boards and the management of both GSEs. I attribute the need for today's action primarily to the inherent conflict and flawed business model embedded in the GSE structure, and to the ongoing housing correction. GSE managements and their Boards are responsible for neither. New CEOs supported by new non-executive Chairmen have taken over management of the enterprises, and we hope and expect that the vast majority of key professionals will remain in their jobs. I am particularly pleased that the departing CEOs, Dan Mudd and Dick Syron, have agreed to stay on for a period to help with the transition.

I have long said that the housing correction poses the biggest risk to our economy. It is a drag on our economic growth, and at the heart of the turmoil and stress for our financial markets and financial institutions. Our economy and our markets will not recover until the bulk of this housing correction is behind us. Fannie Mae and Freddie Mac are critical to turning the corner on housing. Therefore, the primary mission of these enterprises now will be to proactively work to increase the availability of mortgage finance, including by examining the guaranty fee structure with an eye toward mortgage affordability.

To promote stability in the secondary mortgage market and lower the cost of funding, the GSEs will modestly increase their MBS portfolios through the end of 2009. Then, to address systemic risk, in 2010 their portfolios will begin to be gradually reduced at the rate of 10 percent per year, largely through natural run off, eventually stabilizing at a lower, less risky size.

Treasury has taken three additional steps to complement FHFA's decision to place both enterprises in conservatorship. First, Treasury and FHFA have established Preferred Stock Purchase Agreements, contractual agreements between the Treasury and the conserved entities. Under these agreements, Treasury will ensure that each company maintains a positive net worth. These agreements support market stability by providing additional security and clarity to GSE debt holders – senior and subordinated – and support mortgage availability by providing additional confidence to investors in GSE mortgage backed securities. This commitment will eliminate any mandatory triggering of receivership and will ensure that the conserved entities have the ability to fulfill their financial obligations. It is more efficient than a one-time equity injection, because it will be used only as needed and on terms that Treasury has set. With this agreement, Treasury receives senior preferred equity shares and warrants that protect taxpayers. Additionally, under the terms of the agreement, common and preferred shareholders bear losses ahead of the new government senior preferred shares.

These Preferred Stock Purchase Agreements were made necessary by the ambiguities in the GSE Congressional charters, which have been perceived to indicate government support for agency debt and guaranteed MBS. Our nation has tolerated these ambiguities for too long, and as a result GSE debt and MBS are held by central banks and investors throughout the United States and around the world who believe them to be virtually risk-free. Because the U.S. Government created these ambiguities, we have a responsibility to both avert and ultimately address the systemic risk now posed by the scale and breadth of the holdings of GSE debt and MBS.

Market discipline is best served when shareholders bear both the risk and the reward of their investment. While conservatorship does not eliminate the common stock, it does place common shareholders last in terms of claims on the assets of the enterprise.

Similarly, conservatorship does not eliminate the outstanding preferred stock, but does place preferred shareholders second, after the common shareholders, in absorbing losses. The federal banking agencies are assessing the exposures of banks and thrifts to Fannie Mae and Freddie Mac. The agencies believe that, while many institutions hold common or preferred shares of these two GSEs, only a limited number of smaller institutions have holdings that are significant compared to their capital.

The agencies encourage depository institutions to contact their primary federal

regulator if they believe that losses on their holdings of Fannie Mae or Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce their regulatory capital below "well capitalized." The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with the capital regulations.

Preferred stock investors should recognize that the GSEs are unlike any other financial institutions and consequently GSE preferred stocks are not a good proxy for financial institution preferred stock more broadly. By stabilizing the GSEs so they can better perform their mission, today's action should accelerate stabilization in the housing market, ultimately benefiting financial institutions. The broader market for preferred stock issuance should continue to remain available for well-capitalized institutions.

The second step Treasury is taking today is the establishment of a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Given the combination of actions we are taking, including the Preferred Share Purchase Agreements, we expect the GSEs to be in a stronger position to fund their regular business activities in the capital markets. This facility is intended to serve as an ultimate liquidity backstop, in essence, implementing the temporary liquidity backstop authority granted by Congress in July, and will be available until those authorities expire in December 2009.

Finally, to further support the availability of mortgage financing for millions of Americans, Treasury is initiating a temporary program to purchase GSE MBS. During this ongoing housing correction, the GSE portfolios have been constrained, both by their own capital situation and by regulatory efforts to address systemic risk. As the GSEs have grappled with their difficulties, we've seen mortgage rate spreads to Treasuries widen, making mortgages less affordable for homebuyers. While the GSEs are expected to moderately increase the size of their portfolios over the next 15 months through prudent mortgage purchases, complementary government efforts can aid mortgage affordability. Treasury will begin this new program later this month, investing in new GSE MBS. Additional purchases will be made as deemed appropriate. Given that Treasury can hold these securities to maturity, the spreads between Treasury issuances and GSE MBS indicate that there is no reason to expect taxpayer losses from this program, and, in fact, it could produce gains. This program will also expire with the Treasury's temporary authorities in December 2009.

Together, this four part program is the best means of protecting our markets and the taxpayers from the systemic risk posed by the current financial condition of the GSEs. Because the GSEs are in conservatorship, they will no longer be managed with a strategy to maximize common shareholder returns, a strategy which historically encouraged risk-taking. The Preferred Stock Purchase Agreements minimize current cash outlays, and give taxpayers a large stake in the future value of these entities. In the end, the ultimate cost to the taxpayer will depend on the business results of the GSEs going forward. To that end, the steps we have taken to support the GSE debt and to support the mortgage market will together improve the housing market, the US economy and the GSEs' business outlook.

Through the four actions we have taken today, FHFA and Treasury have acted on the responsibilities we have to protect the stability of the financial markets, including the mortgage market, and to protect the taxpayer to the maximum extent possible.

And let me make clear what today's actions mean for Americans and their families. Fannie Mae and Freddie Mac are so large and so interwoven in our financial system that a failure of either of them would cause great turmoil in our financial markets here at home and around the globe. This turmoil would directly and negatively impact household wealth: from family budgets, to home values, to savings for college and retirement. A failure would affect the ability of Americans to get home loans, auto loans and other consumer credit and business finance. And a failure would be harmful to economic growth and job creation. That is why we have taken these actions today.

While we expect these four steps to provide greater stability and certainty to market

participants and provide long-term clarity to investors in GSE debt and MBS securities, our collective work is not complete. At the end of next year, the Treasury temporary authorities will expire, the GSE portfolios will begin to gradually run off, and the GSEs will begin to pay the government a fee to compensate taxpayers for the on-going support provided by the Preferred Stock Purchase Agreements. Together, these factors should give momentum and urgency to the reform cause. Policymakers must view this next period as a "time out" where we have stabilized the GSEs while we decide their future role and structure.

Because the GSEs are Congressionally-chartered, only Congress can address the inherent conflict of attempting to serve both shareholders and a public mission. The new Congress and the next Administration must decide what role government in general, and these entities in particular, should play in the housing market. There is a consensus today that these enterprises pose a systemic risk and they cannot continue in their current form. Government support needs to be either explicit or non-existent, and structured to resolve the conflict between public and private purposes. And policymakers must address the issue of systemic risk. I recognize that there are strong differences of opinion over the role of government in supporting housing, but under any course policymakers choose, there are ways to structure these entities in order to address market stability in the transition and limit systemic risk and conflict of purposes for the long-term. We will make a grave error if we don't use this time out to permanently address the structural issues presented by the GSEs.

In the weeks to come, I will describe my views on long term reform. I look forward to engaging in that timely and necessary debate.

-30-

REPORTS

- [FHFA Director Lockhart Remarks on Housing GSE Actions](#)
- [Fact Sheet: FHFA Conservatorship](#)
- [Fact Sheet: Treasury Preferred Stock Purchase Agreement](#)
- [Fact Sheet: Treasury MBS Purchase Program](#)
- [Fact Sheet: Treasury GSE Credit Facility](#)
- [Freddie Mac Warrant to Purchase Common Stock](#)
- [Freddie Mac Certificate](#)
- [Freddie Mac Senior Preferred Stock Purchase Agreement](#)
- [Fannie Mae Warrant to Purchase Common Stock](#)
- [Fannie Mae Certificate](#)
- [Fannie Mae Senior Preferred Stock Purchase Agreement](#)

TAB 28

From: Jones, Catherine P (NY) <catherine.p.jones@lehman.com>
Sent: Tuesday, September 9, 2008 12:08 PM (GMT)
To: McGee III, Hugh E <hmcgee@lehman.com>; Wieseneck, Larry <lwiesene@lehman.com>; Shafir, Mark G <mark.shafir@lehman.com>; Whitman, Brad <bwhitman@lehman.com>; Sullivan, Tim [IBD] <tsullivan@lehman.com>
Cc: Wise, Monique <monique.wise@lehman.com>
Subject: Dow Jones: Korea FSC: KDB, Lehman Investment Talks Have Ended

UPDATE: Korea FSC: KDB, Lehman Investment Talks Have Ended
By Jin-Young Yook
Dow Jones International News
09/09/08

South Korea's Financial Services Commission Chairman Jun Kwang-woo said Tuesday that talks between state-run Korea Development Bank (KDB) and Lehman Brothers Holdings Inc. (LEH) have ended.

The two companies have been discussing the possibility of KDB taking a stake in Lehman but Korean regulators had been cautious about the deal.

Jun told Dow Jones Newswires that the talks were now over, but he declined to say what conclusions, if any, had been reached.

"There will be other opportunities (for KDB)," said Jun.

Separately, another government official, who declined to be named, told Dow Jones Newswires that although KDB had seriously considered investing in Lehman, it has decided not to.

KDB officials declined to comment.

On Monday, Jun cautioned against KDB's plan to buy a stake in Lehman as the timing wasn't good. He said KDB can review opportunities for investing in a global investment firm after its privatization gets underway. But he stopped short of saying that the talks had officially ended.

The FSC, which oversees KDB's operations, plans to hive off KDB's policy finance operations and transform it into a private global investment bank within five years.

Earlier Tuesday, KDB Chief Executive Min Euoo-sun told a group of reporters that it wouldn't be appropriate to comment on how the talks to acquire a stake in Lehman were proceeding. But he said KDB could still become one of Asia's top three investment banks even without Lehman.

Min, who previously headed Lehman's Korean operations, reiterated that the drop in share prices of global financial institutions provided "good timing" for KDB's global expansion strategy in the next couple of years.

"To start with, we will enter the Asian market, including China and Southeast Asia, to position ourselves as a leading bank of Asia. Then, we will expand our presence to the Americas and Europe," Min said in a speech delivered at a forum.

He added that KDB will acquire competitive financial institutions.

Korea daily Chosun Ilbo, reported last week that KDB had sent a proposal to Lehman to buy 25% of the U.S. investment bank for as much as \$5.3 billion.

KDB later confirmed it was talking with Lehman on a possible stake investment deal and that it was trying to form a consortium of private investors to jointly invest in Lehman.

But all major financial institutions in South Korea - Kookmin Bank, Woori Finance Holdings, Shinhan Financial Group and Hana Financial Holdings - said that they weren't interested in joining a consortium to invest in Lehman due to economic uncertainties on the local front, spurring speculation that KDB wouldn't go ahead with the plan.

It has been a terrible year for the 158-year-old Lehman. Its shares have tumbled almost 80% since January amid concerns about sizable mortgage holdings in its portfolio, and it has been trying to find suitable investors from foreign ground to save the firm.

Merrill Lynch & Co. drastically reduced this week its earning estimates for the bank, predicting the company would post a loss of \$6.50 a share, or \$4.6 billion, much wider than an earlier third-quarter loss estimate of \$3.94 a share.

Lehman is looking at spinning off some of its real estate assets into a separate company and is also seeking bidders for its investment-management unit, which includes the profitable asset manager Neuberger Berman.

Catherine P. Jones
Vice President
Media Relations
Lehman Brothers
1271 Sixth Avenue, 45th Floor
New York, New York 10020
Office: 212-526-4064
Mobile: 917-743-7683

P Please consider the environment before printing this e-mail.

TAB 29

**Meg
McConnell/NY/FRS**

09/09/2008 11:07 AM

To Meg McConnell/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Chris McCurdy/NY/FRS@FRS, Clinton Lively/NY/FRS@FRS, Craig Leiby/NY/FRS@FRS, Debby Perelmutter/NY/FRS@FRS, Dianne Dobbeck/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS, James P Bergin/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, Jonathan Polk/NY/FRS@FRS, Lucinda M Brickler/NY/FRS@FRS, Michael Holscher/NY/FRS@FRS, Michael Schetzel/NY/FRS@FRS, Patrick M Parkinson/BOARD/FRS@BOARD, Sandy Krieger/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS, Steven Friedman/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Theodore Lubke/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, Wendy Ng/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS

cc Kristin Mayer/NY/FRS@FRS, Michael Silva/NY/FRS@FRS

Subject Quick comparison 

As he mentioned in the meeting this morning, Tim would like someone to put together a quick "what's different? what's the same?" list about LEH vs BSC, as well as about mid-March (then) vs. early Sept (now). He would like this for a call he's having with Chairman Bernanke at 3:00. Any takers for this? Please let me know.

Thanks,
Meg

Margaret M. McConnell
Federal Reserve Bank of New York
212-720-8773

▼ Meg McConnell

----- Original Message -----

From: Meg McConnell

Sent: 09/08/2008 06:44 PM EDT

To: Arthur Angulo; Brian Peters; Chris McCurdy; Clinton Lively; Craig Leiby; Debby Perelmutter; Dianne Dobbeck; HaeRan Kim/NY/FRS@NY; James Bergin; Jamie McAndrews; Jan Voigts; Jonathan Polk; Lucinda Brickler; Meg McConnell; Michael Holscher; Michael Schetzel; Patrick Parkinson; Sandy Krieger; Sarah Dahlgren; Steven Friedman; Terrence Checki/NY/FRS@NY; Theodore Lubke; Thomas Baxter; Til Schuermann; Wendy Ng; William BRODOWS

Cc: Kristin Mayer; Michael Silva

Subject: Meeting tomorrow at 9:00

The purpose of tomorrow's meeting is to continue the discussion of near-term options for dealing with a failing nonbank. Sorry for the late notice on this meeting.
Meg

Derivatives: Top 25 Counterparties by Current Exposure (to Lehman)

Counterparty	Industry Description	CCE (\$mm)	MPE (\$mm)	Deal counts
MINISTRY OF FINANCE ITALY ⁽¹⁾	CENTRAL GOVERNMENT DEPAR	2,878	5,300	16
BH FINANCE LLC ⁽²⁾	MISC FINANCE COMPANIES	1,445	2,854	44
PYXIS ABS CDO 2007-1 LTD	SPECIAL PURPOSE VEHICLE	1,085	1,128	125
LIBRA CDO LIMITED	SPECIAL PURPOSE VEHICLE	889	961	146
MKP VELA CBO LTD	SPECIAL PURPOSE VEHICLE	877	981	110
CENTRAL BANK OF NORWAY (NORGES BANK)	CENTRAL BANK	543	727	1,560
KBC INVESTMENTS CAYMAN ISLANDS V LTD	SPECIAL PURPOSE VEHICLE	435	500	1
BALLYROCK ABS CDO 2007-1 LTD	SPECIAL PURPOSE VEHICLE	392	420	108
CANADIAN NATURAL RESOURCES	OIL/GAS COMPANY	379	484	26
GE FINANCIAL MARKETS	GENERAL MANUFACTURER	369	512	110
PORTFOLIO CDS TRUST 187	FINANCIAL GUARANTOR	357	390	1
TEXAS COMPETITIVE ELECTRIC HOLDINGS CO LLC	UTILITY-INVeSTOR OWNED/IND	334	1,059	8
PRESIDENT AND FELLOWS OF HARVARD COLLEGE	COLLEGES/UNIVERSITIES	298	321	200
MINISTRY OF FINANCE GERMANY	CENTRAL GOVERNMENT DEPAR	291	410	62
DEUTSCHE BANK AG	COMMERCIAL BANK	283	1,480	59,149
AGR FINANCIAL PRODUCTS INC	FINANCIAL GUARANTOR	275	364	75
EUROPEAN INVESTMENT BANK	SUPRANATIONALS - MULTI GOVT	268	525	22
MIZUHO INTERNATIONAL PLC	BROKER DEALER GENERAL	260	714	8,820
CHESAPEAKE ENERGY CORPORATION	OIL/GAS COMPANY	247	999	268
CALYON	COMMERCIAL BANK	225	1,072	7,397
JPMORGAN CHASE BANK NA	COMMERCIAL BANK	213	1,323	53,036
LINN ENERGY LLC	OIL/GAS COMPANY	207	418	30
RUBY FINANCE 2008-01	LEHMAN SPECIAL PURPOSE VEH	33	83	5
MORGAN STANLEY CAPITAL SERVICES INC	BROKER DEALER GENERAL	173	675	40,283
801 GRAND CDO SPC SERIES 2006-1	LEHMAN SPECIAL PURPOSE VEH	173	280	9

⁽¹⁾ Exposure reported above does not reflect hedges we have against our exposure, including \$1,899m of long credit protection. Actual CCE and MPE net of hedges was \$979m and \$3,401m respectively.

⁽²⁾ Exposure reported above does not reflect \$710m of CDS hedges we have against our exposure. Actual CCE and MPE net of hedges was \$735m and \$2,144m respectively.

Derivatives: Top 25 Counterparties by Deal Count

Counterparty	Industry Description	CCE (\$mm)	MPE (\$mm)	Deal counts
DEUTSCHE BANK AG	COMMERCIAL BANK	283	1,480	59,149
JPMORGAN CHASE BANK NA	COMMERCIAL BANK	213	1,323	53,036
UBS AG	COMMERCIAL BANK	43	832	44,619
MORGAN STANLEY CAPITAL SERVICES INC	BROKER DEALER GENERAL	173	675	40,283
BARCLAYS BANK PLC	COMMERCIAL BANK	100	1,251	36,912
CITIBANK NA	COMMERCIAL BANK	92	804	24,816
BANK OF AMERICA NATIONAL ASSOCIATION	COMMERCIAL BANK	56	579	23,188
ROYAL BANK OF SCOTLAND PLC (THE)	COMMERCIAL BANK	19	602	22,294
GOLDMAN SACHS INTERNATIONAL	BROKER DEALER GENERAL	77	372	18,896
BNP PARIBAS	COMMERCIAL BANK	147	864	18,609
MERRILL LYNCH INTERNATIONAL	BROKER DEALER GENERAL	20	311	17,289
BEAR STEARNS CREDIT PRODUCTS INC	BROKER DEALER GENERAL	38	244	16,890
SOCIETE GENERALE	COMMERCIAL BANK	77	860	12,021
MIZUHO INTERNATIONAL PLC	BROKER DEALER GENERAL	260	714	8,820
ABN AMRO BANK NV	COMMERCIAL BANK	22	641	7,854
CALYON	COMMERCIAL BANK	225	1,072	7,397
HSBC BANK USA	COMMERCIAL BANK	82	223	5,781
DRESDNER BANK AG	COMMERCIAL BANK	70	328	5,767
AIG INTERNATIONAL INC	INSURANCE-LIFE/HEALTH	17	49	5,445
BANK OF TOKYO MITSUBISHI UFJ LTD	COMMERCIAL BANK	76	134	4,103
NATIXIS	COMMERCIAL BANK	52	350	3,799
WACHOVIA BANK NATIONAL ASSOCIATION	COMMERCIAL BANK	27	367	3,375
MORGAN STANLEY CAPITAL GROUP, INC.	BROKER/DEALER COMMODITIES	23	94	2,740
BAYERISCHE HYPO-UND VEREINSBANK AG	COMMERCIAL BANK	90	309	2,353
COMMERZBANK AG	COMMERCIAL BANK	114	523	2,201

External Trade Count

Deal Counts by Product as of May 30, 2008	
Product	Trade Counts as of 5/30/2008
DEFAULT SWAP	361,020
SWAP	212,825
FOREX	136,876
FORWARDS	30,850
EQUITY DERIVATIVES	18,864
OTHER DERIVATIVES	159,796
SUBTOTAL DERIVATIVES	920,231
SBL	189,894
MARGIN LENDING	166,034
REPO	31,053
MLMF	280
TOTAL	1,307,492
Legal Entity	Trade Counts as of 5/30/2008
LBSF	592,138
LBCC	115,286
LBJ	57,340
LBCS	27,971
LBFI	16,362
EAUS	11,850
LBCE	6,461
LOTC	2,036
LBBK	1,968
LBLUX	1,603
LBCCA	1,482
LFIS	1,076
LBKR	903
ALL OTHER	2,493
SUBTOTAL	838,969
LBIE	254,309
LBI	214,214
TOTAL	1,307,492

LEHMAN'S VIEW OF LEHMAN VS. BEAR			
Key Liquidity Metrics	Presentation to FRBNY on 5/28/08		"Gameplan" 9/2/08
	Bear	Lehman	Lehman
	Q108	Q108	Q308
Net Balance Sheet	254	397	315
Net Leverage	22.6x	15.4x	10.7x
Liquidity Pool	17	34	41
STD (excluding current portion)	16	16	
Current Portion LTD	10	19	
Total Short-term Debt	26	35	
Short-term Debt/Liquidity Pool	1.5x	1.0x	
Unencumbered Assets	14	161	
Free Credit Balances	43	13	1

From: [Lucinda M Brickler](#)
To: [Meg McConnell](#)
Cc: [Arthur Angulo](#); [Brian Peters](#); [Chris McCurdy](#); [Clinton Lively](#); [Craig Leiby](#); [Debby Perelmutter](#); [Dianne Dobbeck](#); [HaeRan Kim](#); [James P Bergin](#); [Jamie McAndrews](#); [Jan Voigts](#); [Jonathan Polk](#); [Kristin Mayer](#); [Michael Holscher](#); [Michael Schetzel](#); [Michael Silva](#); [Patrick M Parkinson](#); [Sandy Krieger](#); [Sarah Dahlgren](#); [Steven Friedman](#); [Theodore Lubke](#); [Til Schuermann](#); [Wendy Ng](#); [William BRODOWS](#); [Timothy Geithner](#)
Subject: Re: Quick comparison
Date: 09/09/2008 02:40 PM
Attachments: [triparty bear versus lb.doc](#)



[triparty bear versus lb.doc](#)

Lucinda Brickler
Payments Policy Function
Federal Reserve Bank of New York
212.720.6132 or 646.720.6132
▼ [Meg McConnell/NY/FRS](#)

**Meg
McConnell/NY/FRS**

09/09/2008 12:39 PM

To William BRODOWS/NY/FRS@FRS, Lucinda M
Brickler/NY/FRS@FRS
cc Arthur Angulo/NY/FRS@FRS, Brian
Peters/NY/FRS@FRS, Chris McCurdy/NY/FRS@FRS,
Clinton Lively/NY/FRS@FRS, Craig Leiby/NY/FRS@FRS,
Debby Perelmutter/NY/FRS@FRS, Dianne
Dobbeck/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS,
James P Bergin/NY/FRS@FRS, Jamie
McAndrews/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS,
Jonathan Polk/NY/FRS@FRS, Kristin
Mayer/NY/FRS@FRS, Michael Holscher/NY/FRS@FRS,
Michael Schetzel/NY/FRS@FRS, Michael
Silva/NY/FRS@FRS, Patrick M
Parkinson/BOARD/FRS@BOARD, Sandy
Krieger/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS,
Steven Friedman/NY/FRS@FRS, Theodore
Lubke/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS,
Wendy Ng/NY/FRS@FRS

Subject Re: Quick comparison

1. Lucinda and McCurdy are doing a "that was then, this is now" analysis for the triparty repo piece.
2. Markets (I think?) is going to do some state of the world comparison.
3. We have Bill B. giving us Leh's version of the difference between them and BSC.

(Not sure whether we want to also do something that focuses narrowly on OTC derivatives, or whether that will be covered in what Brodows sends?).

These would need to be ready by around 2:45 or so at the latest.
Thanks!

Meg

Margaret M. McConnell
Federal Reserve Bank of New York
212-720-8773

▼ William BRODOWS

----- Original Message -----

From: William BRODOWS
Sent: 09/09/2008 12:22 PM EDT
To: Lucinda Brickler
Cc: Arthur Angulo; Brian Peters; Chris McCurdy; Clinton Lively; Craig Leiby; Debby Perelmutter; Dianne Dobbeck; HaeRan Kim; James Bergin; Jamie McAndrews; Jan Voigts; Jonathan Polk; Kristin Mayer; Meg McConnell; Michael Holscher; Michael Schetzel; Michael Silva; Patrick Parkinson; Sandy Krieger; Sarah Dahlgren; Steven Friedman; Terrence Checki; Theodore Lubke; Thomas Baxter; Til Schuermann; Wendy Ng
Subject: Re: Quick comparison

I have Lehman's own analysis of differences between their position and position of Bear which I will forward.

▼ Lucinda M Brickler/NY/FRS

**Lucinda M
Brickler/NY/FRS**

09/09/2008 11:28 AM

To Meg McConnell/NY/FRS@FRS
cc Arthur Angulo/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Chris McCurdy/NY/FRS@FRS, Clinton Lively/NY/FRS@FRS, Craig Leiby/NY/FRS@FRS, Debby Perelmutter/NY/FRS@FRS, Dianne Dobbeck/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS, James P Bergin/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, Jonathan Polk/NY/FRS@FRS, Kristin Mayer/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS, Michael Holscher/NY/FRS@FRS, Michael Schetzel/NY/FRS@FRS, Michael Silva/NY/FRS@FRS, Patrick M Parkinson/BOARD/FRS@BOARD, Sandy Krieger/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS, Steven Friedman/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Theodore Lubke/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, Wendy Ng/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS

Subject Re: Quick comparison 

Meg

Chris McCurdy and I will put together the "that was then, this is now" analysis for the triparty repo piece.

Lucinda

Lucinda Brickler
Payments Policy Function
Federal Reserve Bank of New York

212.720.6132 or 646.720.6132

▼ Meg McConnell/NY/FRS

**Meg
McConnell/NY/FRS**

09/09/2008 11:07 AM

To Meg McConnell/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Chris McCurdy/NY/FRS@FRS, Clinton Lively/NY/FRS@FRS, Craig Leiby/NY/FRS@FRS, Debby Perelmutter/NY/FRS@FRS, Dianne Dobbeck/NY/FRS@FRS, HaeRan Kim/NY/FRS@FRS, James P Bergin/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, Jonathan Polk/NY/FRS@FRS, Lucinda M Brickler/NY/FRS@FRS, Michael Holscher/NY/FRS@FRS, Michael Schetzel/NY/FRS@FRS, Patrick M Parkinson/BOARD/FRS@BOARD, Sandy Krieger/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS, Steven Friedman/NY/FRS@FRS, Terrence Checki/NY/FRS@FRS, Theodore Lubke/NY/FRS@FRS, Thomas Baxter/NY/FRS@FRS, Til Schuermann/NY/FRS@FRS, Wendy Ng/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS

cc Kristin Mayer/NY/FRS@FRS, Michael Silva/NY/FRS@FRS

Subject Quick comparison 

As he mentioned in the meeting this morning, Tim would like someone to put together a quick "what's different? what's the same?" list about LEH vs BSC, as well as about mid-March (then) vs. early Sept (now). He would like this for a call he's having with Chairman Bernanke at 3:00. Any takers for this? Please let me know.

Thanks,
Meg

Margaret M. McConnell
Federal Reserve Bank of New York
212-720-8773

▼ Meg McConnell

----- Original Message -----

From: Meg McConnell

Sent: 09/08/2008 06:44 PM EDT

To: Arthur Angulo; Brian Peters; Chris McCurdy; Clinton Lively; Craig Leiby; Debby Perelmutter; Dianne Dobbeck; HaeRan Kim/NY/FRS@NY; James Bergin; Jamie McAndrews; Jan Voigts; Jonathan Polk; Lucinda Brickler; Meg McConnell; Michael Holscher; Michael Schetzel; Patrick Parkinson; Sandy Krieger; Sarah Dahlgren; Steven Friedman; Terrence Checki/NY/FRS@NY; Theodore Lubke; Thomas Baxter; Til Schuermann; Wendy Ng; William BRODOWS

Cc: Kristin Mayer; Michael Silva

Subject: Meeting tomorrow at 9:00

The purpose of tomorrow's meeting is to continue the discussion of near-term options for dealing with a failing nonbank. Sorry for the late notice on this meeting.
Meg

What do we know about conditions in the triparty repo market in September 2008 that we either did not know or that has changed since the situation in March 2008?

- We didn't/don't know much about Bear's triparty repo book
 - It was probably about \$50-80 billion, depending on who was talking
 - It was probably weighted heavily toward MBSs
- We know much more about Lehman's triparty repo book
 - Size much larger than Bear

	Value of Collateral	Percentage of Value
OMO Eligible	\$128 billion	70%
Treasury	\$35 billion	19%
Agency debt	\$28 billion	15%
Agency MBS	\$65 billion	35%
Non-OMO PDCF-eligible	\$31 billion	17%
Non-OMO, non-PDCF	\$23.5 billion	13%
TOTAL	\$182	100%

- Term of financing percentage financed for more than one night increases for less liquid collateral

OMO-eligible	17%
Non-OMO, PDCF	33%
Non-PDCF	50%

- Margins for less liquid collateral, particularly non-investment grade private label CMOs and asset-backed securities, are higher (and are probably more rational than they were in March)
- Investors concentration is high with the top 10 counterparties providing 80% of the financing; the good news is that these are all sophisticated advisors and investors who should be expected to take a professional view of the issues; the bad news is that they are investing others' money and need to meet fiduciary responsibilities and avoid perception of being too exposed
 - BNYM (sec lending and asset mgmt) \$35 billion (19%)
 - JPMC and State Street \$35 billion
 - Fidelity \$12 billion
- Post-bear, investors may be quicker to withdraw funds
 - PDCF is a backstop

- Fidelity is the only 2a7 fund in the top 10 investors, generally accepts lower quality collateral, will likely be among the first to flee
 - Lesson from March was that it is better to be the first to flee than the last
- We know that the matched book is large in nominal terms (\$550 billion+), but we have no insights as to the degree of double counting or netting that this number involves. The consequence of an unwind would be to cause dislocations (of unknown severity) for a fair number of investors/market players who rely on the intermediation provided by Lehman.
- We now know that clearing banks do not have the technical capacity to effect an unwind by collateral type (only by firm and with some effort by trade). This was an option considered during the Countrywide episode that the clearing banks, in fact, would not have been able to operationalize.
- Other concerns
 - Intraday liquidity provided by settlement banks may be a problem as LB's situation deteriorates. Citi, JPMC and we believe BofA have all demanded more margin from LB for providing clearing and settlement liquidity. We know that Citibank is watching them closely on an international basis and if they become uncomfortable, they will likely demand more intra-day margin and will likely cut off Lehman if they don't receive it. LB has a much larger international footprint than Bear had.
 - DTCC complex is likely watching Lehman more closely and could raise participants fund deposits or cut net debit cap if they feel uncomfortable. Most likely they would not do this without speaking to us first. A concern is that uncertainties/misperceptions about closeout procedures may still exist among CC participants, which could cause them to pull back from the CC to avoid loss sharing.

TAB 30

[REDACTED]

From: Patrick.M.Parkinson@frb.gov
Sent: Tuesday, September 09, 2008 10:14 AM
To: Shafran, Steven
Subject: Re: now i am on a conf call

A series of LB calls. Concern that they will be announcing further losses next week and may not succeed in raising new equity. Liquidity position is not as bad as BS but still vulnerable to a loss of confidence. What are our options if, unlike BS, no buyer materializes?

I should be available between 11:30 and 11:45, maybe a bit earlier than 11:30.

Pat

Steven.Shafran@do
.treas.gov

09/09/2008 10:08
AM

Patrick.M.Parkinson@frb.gov

To

cc

Subject

now i am on a conf call

Can talk via email. Whats up?

Steven Shafran

Senior Advisor to the Secretary

U.S. Department of Treasury

Cell: 202-674-2696

Office: 202-622-1593

Email: steven.shafran@do.treas.gov

TAB 31

From: [Rita C Proctor](#)
To: [Donald L Kohn](#); [Kevin Warsh](#); [Michelle A Smith](#); [Scott Alvarez](#); [Brian F Madigan](#); [Patrick M Parkinson](#); [Marie L Spicer](#)
Cc: [Rivane V Bowden](#); [Margaret Owens](#); [Valerie Delaney](#); [Cecelia M Bradshaw](#); [Julie Edwards](#); [Yvette K McKnight-Johnson](#); [Cecelia M Bradshaw](#)
Subject: This evening's conference call will take place at 5 p.m. instead of 6 p.m.
Date: 09/09/2008 04:26 PM

Tuesday, September 9, 2008

05:00 PM - 06:00 PM Conference Call [re: Lehman Brothers]
Location: Chairman's Office
Principals: Secy. Paulson, Secy. Cox, Chairman Bernanke, Vice Chairman Kohn(?) Governor Warsh & President Geithner
Board Staff: Scott Alvarez, Brian Madigan, Pat Parkinson & Michelle Smith
FRB NY Staff: Arthur Angulo, Thomas Baxter & William Rutledge

Conference bridge information:

Toll Free Dial In Number: **(866) 209-6438**
Participant Code: **623345**
Int'l Access/Caller Paid Dial In Number: (865) 297-1127

TAB 32

[REDACTED]

From: Davis, Michele
Sent: Tuesday, September 09, 2008 5:27 PM
To: Wilkinson, Jim
Subject: RE:

Is hank going to NY?

-----Original Message-----

From: Wilkinson, Jim
Sent: Tuesday, September 09, 2008 5:20 PM
To: Davis, Michele
Subject:

We need to talk...I just can't stomach us bailing out lehman. Will be horrible in the press don't u think?

TAB 33

FINAL TRANSCRIPT

Thomson StreetEvents™

LEH - Q3 2008 Preliminary Lehman Brothers Holdings Inc. Earnings Conference Call

Event Date/Time: Sep. 10. 2008 / 8:00AM ET

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www.streetevents.com

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Sep. 10. 2008 / 8:00AM, LEH - Q3 2008 Preliminary Lehman Brothers Holdings Inc. Earnings Conference Call

CORPORATE PARTICIPANTS

Shaun Butler

Lehman Brothers - IR Director

Dick Fuld

Lehman Brothers - Chairman, CEO

Ian Lowitt

Lehman Brothers - CFO

Bart McDade

Lehman Brothers - President, COO

CONFERENCE CALL PARTICIPANTS

Glenn Schorr

UBS - Analyst

Michael Hecht

Banc of America Securities - Analyst

Mike Mayo

Deutsche Bank - Analyst

Douglas Sipkin

Wachovia Securities - Analyst

Bill Tanona

Goldman Sachs - Analyst

Guy Moszkowski

Merrill Lynch - Analyst

PRESENTATION

Operator

Good morning and welcome to Lehman Brothers investor conference call. At this time all participants are in a listen-only mode. [Operator Instructions]. Today's call is being recorded, and if you have any objections you may disconnect at this time.

I would now like to turn the call over to Ms. Shaun Butler, Director of Investor Relations. Ms. Butler, you may begin.

Shaun Butler - *Lehman Brothers - IR Director*

Thank you for joining us this morning. Before we begin, let me point out that this presentation contains forward-looking statements. These statements are not guarantees of future performance. They only represent the firm's current expectations, estimates and projections regarding future events.

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. These forward-looking statements are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are difficult to predict and beyond our control.

For more information concerning the risks and other factors that could affect the firm's future results and financial condition, see risk factors and management's discussion and analysis of financial condition and results of operation in the firm's most recent annual report on Form 10-K and the most recent quarterly report on Form 10-Q as filed with the SEC. The firm's financial

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Sep. 10. 2008 / 8:00AM, LEH - Q3 2008 Preliminary Lehman Brothers Holdings Inc. Earnings Conference Call

statements for the third fiscal quarter of 2008 are not finalized until they have filed in its quarterly report on Form 10-Q for the third fiscal quarter of 2008.

The firm is required to consider all available information through the finalization of its financial statements, and the possible impact on its financial condition and results of operations for the reporting period, including the impact of such information on the complex and subjective judgments that will be discussed on today's call, as well as estimates the firm made in preparing certain of the preliminary information included in these remarks. Subsequent information or events may lead to material differences between the preliminary results of operations described in these remarks, and the results of operations that will be described in the firm's subsequent earnings release, and between such subsequent earnings release and results of operations described in the firm's quarterly report on Form 10-Q for the third fiscal quarter of 2008.

Those differences may be adverse. Listeners to these remarks should consider this possibility. This presentation contains certain non-GAAP financial measures relating to these financial – information relating to these financial measures can be found in the morning's preliminary earnings press release which has been posted on the firm's website, www.Lehman.com and filed with the SEC in a Form 8-K available at www.SEC.gov.

At the end of the call we will open the session to Q&A, and Bart McDade will be joining us for that portion of the call. I will now turn the call over to Dick Fuld.

Dick Fuld - *Lehman Brothers - Chairman, CEO*

Shaun, thank you. I want to thank all of you for joining us today on what's clearly short notice.

In light of these last two days, this morning we pre-released our quarterly results. We are also announcing several important financial and operating changes that amount to a significant repositioning of the firm, including aggressively reducing our exposure to both commercial real estate and residential real estate assets.

These will accomplish a substantial de-risking of our balance sheet and reinforce the emphasis on our client-focused businesses. They are also meant to mitigate the potential for future write-downs, and to allow the firm to return to profitability and strengthen our ability to earn appropriate risk-unadjusted equity returns.

I will discuss the strategic actions we are taking to restructure and reposition the firm, and then the rationale for each. After my comments, Ian will discuss the mechanics of the various transactions, our results for the quarter, our remaining asset exposures at the quarter end, and pro forma for today's announcements and our current capital and liquidity positions.

This quarter's loss was mostly due to the sales and write-downs of our residential and commercial real estate assets (technical difficulty) extent, a slower business environment. Since the second quarter, there was a significant additional deterioration in the credit markets, and with a disproportionate impact on the legacy asset classes where we had remaining exposures.

In addition, part of the move to more quickly exit the real estate positions further added to the losses. As you know over the past few quarters our plan was to protect our shareholders, our capital and our franchise by maintaining strong liquidity and exiting our real estate exposures in a measured way over time.

Losses created by these concentrated legacy assets have clouded the underlying value of our franchise. In addition, there's been intense public scrutiny which caused us significant distractions among our clients, our counterparties, and also our employees.

When you look at our segment performance, investment banking, fixed income and equities and IMD, our market share and how we are winning mandates, you'll see that our client relationships remain strong. Now, I spent a great deal of time in this

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quarter with our clients, our creditors and our employees. And while they continue to stand with us, we nevertheless cannot put the strength of our franchise and their continued trust at risk.

The set of decisions announced today will best protect the core client franchise, and create a very clean, liquid balance sheet. So today we are taking a number of necessary actions. Here's the summary.

We put a concrete plan in place to exit the vast majority of our commercial real estate. We are reducing our residential and leveraged loan exposures down to appropriate operating levels.

We are in the final stages of raising capital with sale of a majority stake in IMD. Strengthening our capital base – excuse me – as we strengthened our capital base in June, protected our liquidity and are cutting our dividend.

We reshaped our human capital and product depth, expense base to these changing markets. Lastly, we implemented a series of management changes, some of which you saw in the last couple of days. Taken together, these actions have quickly de-risked and resized the firm. Let me just go through each in more detail.

Today we announced a plan to separate a vast majority of our commercial real estate assets from our core business by spinning off those assets to our shareholders and to an independent, publicly-traded entity which will be adequately capitalized. The spinoff improves our balance sheet while preserving value for our shareholders. The spinoff entity will be able to manage its assets for economic value maximization over a longer time horizon, given the fact that it will not be a marked-to-market entity but rather use held-to-maturity accounting.

This will preserve economic value for our shareholders. We also significantly reduced the residential mortgage and acquisition finance exposures. In addition to the sell-down of residential over the course of this quarter, we are finalizing with BlackRock a bulk sale of our UK residential assets (technical difficulty) sale within the next few weeks.

This will bring our total residential exposure down by approximately half since the second quarter. These remaining residential assets have been significantly marked down, and are now at levels that imply a default and cumulative loss rates well above the fundamental expectations. Ian will provide further transparency here, including detail on how we are marking the remaining positions.

Next, let me talk about our investment management division. (technical difficulty) more thorough review of this business and reached out to third parties to validate the value proposition that we've been building. While IMD continues to have a strategic connection to some of our other businesses, and adds diversification value to our earnings, we believe that we can capture capital benefits of a partial monetization while also continuing to build value through a series of commercial partnering agreements.

We are in the final stages of selling a majority stake in our IMD business. We've been running a process with selected strategic and financial investors, and we expect to reach a definitive agreement on a transaction that appropriately values this attractive asset and maintains a strategic relationship.

This will serve two primary purposes – one, raise tangible equity capital for the firm on a cost-efficient basis; and two, maintain strategic ties to the business through commercial arrangements and a large minority stake which will continue to give us a significant amount of IMD's earnings into our income. Next, we are cutting our annual dividend to \$0.05 per share to preserve capital, given the near-term operating environment.

We ended the quarter with more tangible equity than we started, and at a net leverage ratio of 10.6 versus 12.1 at the end of the second quarter. We'll think about future capital by looking at the total equity capital raised from IMD, and by ensuring the core Lehman Brothers after the commercial real estate spinoff has proper tangible capital to support our client franchise.

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Taking all this together, the spinoff of our commercial real estate assets, the significant reduction in our residential and acquisition finance exposure, monetization of a majority stake in IMD, dividend cut, we will have what we believe to be a strong and clean balance sheet which will allow us to focus on supporting our core client businesses. In addition to all of this, we remain committed to examining all strategic alternatives to maximize shareholder value.

This firm has a history of facing adversity and delivering. We have a long track record of pulling together when times are tough and then taking advantage of global opportunities.

I believe as a firm we've made (technical difficulty) choices and we've put the changes in place. We are on the right track to put these last two quarters behind us.

We will not be distracted from our (technical difficulty) which is protecting and building our client franchise. Today's strategic actions, each of which is significant in its own right, taken together as a whole significantly reduces our remaining risk and greatly improves our ability to create value for our shareholders.

So I want to thank our clients, thank our counterparties for their tremendous support during this period. Today we've taken definitive steps and have put in place a credible plan. Ian, let me turn it over to you now.

Ian Lowitt - *Lehman Brothers - CFO*

Thanks, Dick. During the past quarter we experienced significant market pressure and scrutiny around our legacy residential and commercial real estate assets, and more recently, speculation around our various strategic alternatives. In the last two trading days, this speculation has intensified such that it became prudent to release our results and clarify our restructuring plan early, recognizing the need to move quickly and decisively to resolve the overhang on our business.

Importantly, as we will discuss today, we ended the third quarter with a capital position and leverage ratios stronger than the second quarter. Total shareholder equity increased 8% to \$28 billion; we reduced net leverage to 10.6 times from 12.1 times, and our Tier 1 capital ratio is estimated at approximately 11% versus 10.7% last quarter.

Today, I shall walk you through our restructuring around commercial real estate, residential mortgages, other asset exposures, and our investment management division. And then I will review our results for the quarter along with our current liquidity and our operating model going forward.

I will start with our commercial real estate initiatives. We face specific concerns with respect to our commercial real estate exposure, which as you know is comprised of a large diversified portfolio of individually underwritten assets.

As of the close of the third quarter, our commercial mortgage and real estate held-for-sale positions totaled \$32.6 billion, down 18% from the \$39.8 million at the end of the second quarter. We have successfully sold down a significant amount of these assets over the past few quarters. In order for us to realize fair value, buyers require lengthy asset-specific diligence on each position.

Despite our success in reducing assets over the past few quarters, the current strategy does not accomplish the disposition of assets quickly enough. To accomplish the goals of rapidly separating us from the legacy commercial assets and enabling our shareholders to retain the value of this portfolio, we will be spinning off the commercial real estate portfolio from our remaining business through the formation of Real Estate Investments Global or REI Global.

We expect to spin REI Global to our existing shareholders as an independently managed and traded public company in the first quarter of 2009. This transaction will separate core Lehman Brothers from these legacy assets, and importantly it will enable

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shareholders to retain upside in this high quality asset portfolio, where the assets will be held to maturity or sold over time in a disciplined manner to optimize value.

Moving on to execution, approximately \$25 billion to \$30 billion of commercial assets are expected to be transferred into REI Global. The exact amount of assets transferred will be determined after taking into account activity in this portfolio until the spinoff is completed. We expect continued paydown and some additional dispositions over this period.

Pro forma for the transaction, our remaining commercial mortgage and real estate held for sale positions in core Lehman are expected to be approximately \$5 billion. The portfolio we expect to contribute to REI Global is highly diversified across regions and asset types. By value, approximately 57% are in the Americas, 26% in Europe, and 17% in Asia. Approximately 58% are debt positions, 26% are equity positions, and 16% are securities.

No property type represents more than 22% of the portfolio, with multifamily at 22%, and office at 18%. And lastly, we also intend to include our SunCal and Archstone positions in this portfolio. This portfolio is currently marked at a weighted average price of 85.

All assets will be transferred to REI Global and are carrying values as of the time of the spin. Our commercial mortgage positions are carried at marked to market, reflecting all current market pricing information for each asset.

The real estate held-for-sale portfolio, consisting of assets across the capital structure, is booked at lower of cost or market as we take write-downs on this book, but do not reflect market value gains until a sale event occurs. REI Global will account for its assets on a held-to-maturity basis and will be able to manage the assets without the pressure of marked to market volatility. REI Global will not be forced to sell assets below what it believes to be their intrinsic value.

In terms of capitalizing REI Global, Lehman Brothers will contribute equity equal to 20% to 25% of asset value and provide debt financing for the 75% to 80% of the total. So it will be capitalized at approximately three to four times debt to book equity, which is consistent with other publicly traded real estate entities.

The firm will spin its entire equity interest in REI Global to Lehman shareholders. Debt financing provided by Lehman Brothers will be liquidity-neutral to Lehman as we currently fund these assets with long-term capital. To the extent we syndicate a portion of the debt, this will have a positive impact on our liquidity.

In aggregate, this pool of assets generates significant cash flow. When combined with the normal course of asset sale activity, these cash flows will be dedicated to paying down debt, managing the assets, and returning cash to REI Global shareholders over time. Based on the expected assets to be contributed to REI Global, the portfolio is projected to generate cash flow through interest income, paydowns, debt repayment, equity distributions, and asset sales.

We estimate cash flow for debt paydown of approximately \$5 billion per year over the next three years. We expect rapid debt paydown at REI Global, with debt to total assets decreasing from 75% to 80%, to approximately 50% within four years. Initially, REI Global expects to pay a modest annual dividend, but once leverage reaches a certain threshold, cash flows may allow for additional distributions to equity.

We have conducted extensive stress tests on the portfolio, and are confident that REI Global has sufficient equity even in severely stressed scenarios. For our stress test, we identified two year time periods from 1990 to 2006 with the largest decline in property values for each property type in every geographic market where REI Global will own material commercial real estate assets, and applied these declines to our current portfolio.

We believe these stress tests are conservative for several reasons. First, we are applying price declines to already marked down positions, and applying worst-case scenarios for all regions and property types simultaneously.

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Second, we assume we sell our assets at the low point of the stress scenario. And finally, our sample timeframe includes periods of severe commercial real estate stress when there were significantly greater oversupply than the current environment.

We applied the stress test before any deleveraging of the portfolio which, given the expected cash flows, should be deleveraging quite rapidly. Even under this extreme stress test, REI Global will be adequately capitalized and is not expected to result in impairment to the debt.

Following the spinoff, our shareholders will hold shares of both Lehman Brothers and REI Global. Importantly, these actions will enable our shareholders to benefit from the intrinsic value of our commercial real estate portfolio.

As part of an independent company without the need to mark to market, assets may be monetized in an orderly manner over time, with more negotiating leverage and at prices which maximize returns. We've resolved all material execution obstacles and are highly confident that we can complete this transaction in the first quarter of 2009.

Moving onto our efforts on the residential front, during the quarter we moved quickly to bring our residential mortgage exposures down significantly, from \$24.9 billion in the second quarter, to \$13.2 billion, a reduction of 47%. This includes a reduction of approximately \$4 billion in UK residential assets that we are formally engaged with BlackRock to sell.

Please note that since the BlackRock transaction will be completed after the close of the third quarter, it will be reflected in our fourth-quarter numbers. Excluding these sales, our residential mortgage position as of the third quarter was \$17.2 billion, a 31% reduction versus last quarter.

After these dispositions, our residential mortgage inventory will be \$13.2 billion, of which approximately 32% of the assets are in less-risky asset classes, including \$1.6 billion of Alt-A servicing rights, and \$600 million of Alt-A AAA I/O securities, both of which have negative correlations to deteriorating markets; and \$600 million of reverse mortgages that have an LTV of approximately 39%, \$500 million in Asia, and approximately \$900 million of assets across the US portfolio in vintages 2005 and earlier.

The rest of the assets – and this includes the \$900 million of the 2005 and earlier vintages – are as follows. \$3.7 billion of additional Alt-A exposure, marked at an average of 39 versus 63 last quarter; \$1.6 billion of subprime and second-lien exposure, marked at an average of 34 versus 55 last quarter; \$3.6 billion of European exposure, marked at an average of 69 versus 83 last quarter; \$500 million of remaining ABS CDO assets, marked at an average of 29 versus 35 last quarter; and \$500 million of additional other US exposure which is marked at an average of 45 versus 48 last quarter. Overall, the US residential book had a weighted average price of 59 at the beginning of the third quarter, and now has a weighted average price of 39, a decline of 20 points.

During the quarter we traded significant US residential assets, with sales of \$5.5 billion and purchases of \$3.2 billion, for total trading activity of \$8.7 billion. This market activity gives us confidence in the accuracy of our marks as of the third quarter.

We'd like to note that we believe current market prices reflect an exceptionally conservative valuation outlook for the US residential market. At current prices, our US residential portfolio generates a 12% yield or approximately LIBOR plus 800 if approximately 50% of the loans default and average recovery rates are only 40%.

This base case assumes national home prices drop 32% peak to trough, versus 18% to date, with California down 50% versus 27% to date. For a 0% yield and only principal repayment, over 80% of the borrowers would need to default with an average 35% recovery rate.

In our Alt-A portfolio, the assets would generate a yield of LIBOR plus 1000, with 44% defaults, LIBOR plus 100 with 63% defaults, and a 0% yield at 79% of defaults, each with a 40% to 45% recovery rate. The current 60-day delinquency rate including real

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estate owned is 18% on this portfolio. So defaults would need to be 2.5 times the current delinquency rates for the LIBOR plus 1000 case, 3.6 times for the LIBOR plus 100 case, and 4.5 times for the 0% yield case.

In our nonprime portfolio, the assets would generate a yield of LIBOR plus 1100 with 59% defaults, LIBOR plus 100 with 76% defaults, and a 0% yield at 85% defaults, each with a 20% to 30% recovery rate assumption. The current 60-plus day delinquency rates including real estate owned is 23% on this portfolio, so defaults would need to be 2.5 times the current delinquency rates for the LIBOR plus 1100 case, 3.2 times for the LIBOR plus 100 case, and 3.7 for the 0% yield case. So current prices imply extremely severe additional deterioration in housing.

Our pro forma remaining \$13.2 billion of residential assets are diversified across product type and region, with about 32% of the exposure in servicing AAA I/O's, reverse mortgages, Asian exposure, and 2005 and earlier vintages. We plan to reduce this position somewhat over the coming quarters, maintaining a balance sheet necessary to support the market-making opportunities. Bid/ask spreads continue to be attractive, with multiple distinct business opportunities across secondary and distressed trading, servicing and NPL management, as well as client advisory.

Regarding other exposures, our other asset-backed positions were reduced by 29%, from \$6.5 billion to \$4.6 billion during the quarter, and we reduced our acquisition finance exposure by 42%, from \$18 billion to \$10.4 billion, which includes a 38% decline in our high yield acquisition finance exposures from \$11.5 billion to \$7.1 billion.

Pro forma for the BlackRock sale and commercial real estate spinoff, our aggregate exposure to residential and commercial mortgage assets, other asset-backed and acquisition finance will be reduced from \$89 billion at the end of the second quarter, to approximately \$30 billion to \$35 billion; so very significant progress in moving the legacy assets and creating a clean balance sheet for core Lehman going forward.

Turning to the investment management division, today we announced our intent to sell a majority stake of a subset of our investment management business. The subset includes our asset management, private equity and wealth management businesses, but excludes our middle-market institutional business which will be folded into capital markets, and our minority stakes in third-party hedge fund managers. This transaction has attractive capital and operating characteristics.

On the capital front, we will be receiving significant proceeds at closing. Additionally, goodwill on our books related to the Neuberger business will be eliminated, resulting in an estimated increase of over \$3 billion in our tangible book value and Tier 1 capital.

Following the transaction closing, IMD's operating results will not be consolidated. Given that we will be retaining a meaningful interest in a subset of IMD, as well as 100% of the middle-market institutional business, and our minority investments in hedge fund managers, the impact on our pretax earnings is estimated to be modest.

On a fiscal 2007 basis, the pro forma impact would have been less than 5% of the firm's pretax earnings. After closing, IMD will have an autonomous governance structure from our investment banking and capital market divisions. However, IMD will remain an important strategic platform for the firm.

The business will continue to operate under the Lehman Brothers and Neuberger Berman brands. Clients will continue to be able to access all of the capabilities of the firm across operating units. We are in advanced discussions with a number of potential partners for the IMD business, and expect to announce the details of the transaction in due course.

We realize that we have given you a lot to absorb with regard to the restructuring, but hopefully we have been able to clarify some of the mechanics and rationale behind our initiatives. To help put our actions into perspective, taking into account all the transactions we have announced today, our balance sheet exposures will be reduced to the following levels – approximately \$5 billion of commercial assets, approximately \$13 billion of residential assets, less than \$5 billion of other asset-backed positions,

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and approximately \$10 billion of acquisition finance facilities which includes \$7 billion of high yield facilities. We believe that the Lehman of early 2009 will be significantly de-risked financial institution.

To reiterate, these actions represent the major components of the restructuring which, once complete, will allow Lehman to emerge as a clean company and be able to thrive away from its legacy assets. This will allow us to refocus our efforts on growing our client-facing franchise. Additionally, core Lehman Brothers can be more fairly valued in the public markets, and we will be better able to restore the confidence of our key stakeholders including equity investors, debt investors, clients, counterparties and employees. We will be discussing core Lehman Brothers in greater detail in the section on our operating model.

Turning to our capital position, despite our third-quarter loss, we ended the quarter with a larger equity base and greater capital ratios versus the prior period, driven by our June capital raise and a decrease in risk-weighted assets. As of June 31, total stockholder equity was approximately \$28 billion, up 8% from the second quarter, and our long-term capital ended the quarter at \$143 billion.

During the quarter we reduced our gross assets by approximately 6%, from \$639 billion to approximately \$600 billion, and we reduced our net assets by approximately 5%, from \$328 billion to approximately \$311 billion. We ended the quarter with gross leverage of 21.1 times, compared to 24.3 times as of the second quarter, and our net leverage was 10.6 times versus 12.1 times last quarter.

We estimate that our Tier 1 capital ratio under the CSC regulatory framework will be approximately 11%, and our total capital ratio between approximately 16.5% and 17% as of August 31, compared to 10.7% and 16.1% at the second quarter, respectively. Our third-quarter Tier 1 ratio is well above our target level, and the total capital ratio is well in excess of the 10% minimum regulatory threshold.

Book value per share declined this quarter to 27.29, driven by the June capital raise and our third-quarter loss. Additionally, the sale of a majority stake in the part of our IMD business, and the reduction in our annual common stock dividend from \$0.68 a share to \$0.05 a share for an annual saving of \$450 million, are both intended to give us greater capital flexibility going forward.

Turning to the third quarter, we posted our second consecutive quarterly loss with net revenues of negative \$2.9 billion, a net loss of \$3.9 billion, and a diluted loss per share of \$5.92. The loss was driven primarily by gross marked to market adjustments of \$7.8 billion, including a \$5.3 billion gross write-down on residential mortgage assets, \$1.7 billion related to our commercial mortgage and real estate portfolio, \$600 million on other asset-backed assets, and \$200 million on our acquisition finance facilities.

Gross marked to market adjustments were offset by \$800 million of hedging gains during the quarter, and \$1.4 billion of debt valuation gains resulting in \$5.6 billion in net write-downs. We also experienced approximately \$716 million of principal losses during the quarter, including approximately \$380 million in fixed income, \$320 million in equities, and \$[50] million in IMD.

Gross write-downs of \$5.3 billion on residential assets in the third quarter were driven by market factors, including rising delinquencies and loss expectations, supply overhang concerns, and a continued difficult financing environment as well as our own accelerated selling activity during the period. Net mark to market adjustments on residential assets totaled \$4.9 billion, as hedges offset only 8% of gross write-downs.

The majority of our write-downs were in Alt-A driven by an increase in Alt-A delinquencies and loss expectations which were specific to Alt-A prices and did not affect the performance of our hedges. Unfortunately there is no direct hedge for Alt-A assets, as there is in subprime with ABX.

Our strategy around hedging is to break the exposures into spread and HBA credit exposure. We use ABX to hedge the HPA exposure, and a combination of CDX, CMBX, single name financial CDS, and swaps to hedge the spread exposure. Our HPA

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hedges were ineffective as Alt-A prices dropped 20 to 25 points during the quarter, while ABX AAA on average dropped eight points and ABX subs -- that's AA through triple B- -- dropped only four points.

And our spread hedges were also ineffective, as residential credit sectors widened significantly by 200 to 600 basis points while other spread sectors were more range bound. Our corporate hedges, for example, widened only 35 basis points. This difficulty in hedging and associated basis risk supported our decision to more rapidly decrease our residential assets this quarter, as our best hedge is to reduce absolute exposure.

In the commercial market, gross marked to market adjustments totaled \$1.7 billion, compared to 900 in the second quarter and \$1.4 billion in the first quarter of 2008.

Real estate values continued to come under pressure during the third quarter, mainly due to the weakening economy and the lack of liquidity in the market. Our write-downs are driven by higher discount rates, changes in our exit capitalization rate assumptions, as well as credit events related to certain properties. On a net basis, commercial write-downs for the quarter totaled \$1.6 billion.

Excluding net marked to market adjustments, debt-valuation gains and principal losses, our remaining revenues were \$3.5 billion, implying positive pretax results of approximately \$600 million and extremely trying circumstances. In investment banking, revenues of \$611 million were in line with a slower overall banking market, where estimated global market fees are down 25% on an annualized basis, year over year.

While underwriting activity was depressed across the debt and equity markets, M&A activity remained solid. We posted revenues of \$634 million in investment management. Our AUM was slightly down at \$273 billion, versus \$277 billion in the second quarter, as market depreciation more than offset net inflows. However, management fees remain stable, quarter over quarter.

Total IMD revenues were done sequentially, driven by lower transactional activity in private investment management, and a smaller contribution from our stakes in alternative asset managers. During the third quarter, we recorded a loss of \$60 million associated with our investments in hedge fund managers, compared to a gain of approximately \$70 million in the second quarter.

In capital markets we reported revenues of negative \$4.1 billion. Excluding net marked to market adjustments, debt valuation gains and losses on principal investments, our run-rate revenues in capital markets were \$2.2 billion, or down 15% versus \$2.6 billion in the second quarter on a comparable basis.

Despite a difficult operating environment in the third quarter, our underlying client franchises remained solid. On a year-to-date basis, capital market client revenues, the internal operating metric by which we track client activity, were up 11% versus the first nine months of last year. And while third-quarter client revenues were down 19% sequentially, this period results are comparable to our average quarterly client revenue for full-year 2007.

In fixed income capital markets, the run-rate revenues were flat versus the second quarter at \$1.8 billion. During the quarter we had strong trading revenues in rates, foreign exchange and credit products. Overall activity levels remained robust year to date, with particular strength in commodities, foreign exchange, securitized product and credit.

In equities capital markets, run rate revenues were approximately \$425 million, down 43% versus \$750 million last quarter. While client revenues were down approximately 22%, run-rate revenues were impacted by trading losses and volatility products.

Cash equities and flow volatility activity generally remained strong in the US this quarter, with more pronounced declines in Europe and Asia. Structured volatility activity remained depressed across regions given the weakening equity market worldwide.

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Prime services revenues and equities were also down from last quarter, mainly reflecting continued deleveraging among hedge fund clients, and diversification of balances across brokers and not a lost clients. Year to date, the prime services business is well ahead of 2007 revenues.

With respect to expenses, given the continued difficult overall market environment, we remain diligent on cost initiatives, with notable developments during the quarter. We've reduced headcount by approximately 1500 positions since the beginning of the third quarter in discretionary corporate areas, and those businesses which we believe are in secular decline. We expect small reductions in staffing in our client-facing businesses, which should bolster our revenue capacity once we reach a more stable part of the cycle.

Non-personnel expenses were \$971 million in the third quarter, down 11% from the \$1.1 billion in the second quarter. We've identified a set of near-term cost reduction opportunities totaling \$250 million in annualized cost savings before any additional impact from potential divestitures.

Although we expect these savings in future quarters, it is important to note that with our third-quarter revenue run rate of \$3.5 billion and third-quarter expenses of \$2.9 billion, we are pretax-positive for the quarter excluding the markdowns, debt valuation gains, and principal losses. I will now provide an update on our liquidity position, which remains very strong.

We maintained our cash capital surplus at \$15 billion at the end of the third quarter. Our liquidity pool also remains strong at \$42 billion, versus a record \$45 billion at May 31. The decline in this figure versus the end of the second quarter is strictly attributable to our managing down our commercial paper outstandings, which ended the quarter at \$4 billion versus \$8 billion at the end of the second quarter.

Funding provided by our wholly owned banking entities also remained stable this quarter, with \$47 billion of assets funded in our banks, versus \$46 billion last quarter. And we have a focused effort to increase this amount in the coming quarters. In particular, we expect amounts funded in our Utah-based industrial bank to increase going forward, as our three year de novo period ended at the end of August.

As an update, on our secured funding positions, total tri-party repo was approximately \$211 billion as of the third quarter, of which \$115 billion is treasuries and agencies. The remaining \$96 billion of tri-party repo compares to the \$105 billion last quarter and includes \$39 billion of collateral which is central-bank eligible.

The \$57 billion of non-central-bank-eligible collateral compares to \$[65] billion of non-eligible collateral last quarter, and includes \$25 billion of highly liquid investment-grade fixed income securities and major index-listed equities. Now, the \$9 billion of non-central-bank-eligible collateral is currently funded through repos with our own banking entities, versus \$8 billion last quarter.

The remaining \$23 billion of collateral, half of which is client collateral, is covered more than 190% by liquidity pools available to the broker-dealers. By comparison, last quarter our remaining collateral was \$32 billion, and this amount was covered more than 150% by liquidity pools available to the broker-dealers.

The average tenor of our non-central-bank eligible tri-party repo remains broadly in line with the last few quarters at over 35 days. Nearly half of our total tri-party repo has a tenor greater than one week, and nearly 30% is over one month. Additionally, we have maintained a significant overfunding position in tri-party repo of approximately \$32 billion, versus \$27 billion last quarter.

Throughout the market volatility of the past six months, our liquidity and funding framework has served us extremely well, and we remain focused on increasing the funding available in our bank entities and mitigating any liquidity risks to our secured and unsecured funding positions. Through last night, our liquidity pool remained essentially unchanged at \$41 billion.

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Let me briefly review our operating model going forward, as we focus again on core Lehman Brothers and executing our business plan in today's market environment. Despite difficult market conditions, essential client needs have not changed. With the need for investment ideas, trading liquidity, and restructuring advice increasing, our core business model remains strong.

We will continue to focus on the client franchise, looking to increase wallet share with a targeted group of global clients. Our client franchise rests on a foundation of delivering intellectual capital through research and our commitment to idea generation, as exemplified by our top-ranked research in both fixed income and equities, as well as differentiated service.

While the market has undoubtedly changed, Lehman's core competencies and culture remain as relevant as ever to the marketplace. Importantly, our operating model going forward incorporates a number of significant attributes. We expect core Lehman Brothers to be well-capitalized with anticipated leverage of 10 to 12 times, and capital to support a \$300 billion net balance sheet, slightly smaller than where we are today.

Clearly, a greater proportion of this balance sheet will be dedicated to client activities, as our real estate-related assets fall from approximately 30% of our total inventory at the end of the third quarter, to approximately 5% under the spinoff scenario. Core Lehman Brothers is intended to have less reliance on wholesale secured funding for our less-liquid assets, and an increased use of bank deposits from our wholly owned bank subsidiaries. And even under the scenario of limited debt-issuing capacity in 2009, we anticipate that core Lehman will have ample cash capital to sustain its business activities.

Under various revenue scenarios, we believe core Lehman Brothers can generate at least \$13 billion of revenues, using a detailed bottoms-up analysis by business and adjusting for the IMD transaction. This is reinforced by our run-rate revenues of \$7.7 billion for the second and third quarters of this year, excluding the marked to market adjustments, debt-valuation gains and principal losses over the last six months, but including IMD for the period.

Our objectives in establishing core Lehman Brothers are to refocus our efforts on growing our client-facing franchise, while restoring the confidence of our key stakeholders, including equity investors, debt investors, clients, counterparties and employees. Additionally, we believe core Lehman Brothers can be more fairly valued in the marketplace.

Let me conclude by making the following points. We believe that the comprehensive plan we've outlined today directly addresses the issues the market has been grappling with in recent weeks. We have introduced a solid plan and timetable to deal with our remaining commercial real estate exposure. We have materially reduced our residential mortgage exposure, and marked our remaining holdings to levels that make future write-downs unlikely.

We have made significant progress in cleansing our balance sheet so that core Lehman can stabilize and ultimately grow and thrive with a strong and clean balance sheet. We have maintained our strong liquidity and capital profiles even in this difficult environment, and the potential sale of IMD further improves our capital position.

Our clients and counterparties have continued to stick with the firm, which has been instrumental in supporting our client run rates, and we believe that core Lehman has the appropriate foundation to achieve sustainable profitability going forward.

That concludes the prepared remarks, and we would like to move on to Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Glenn Schorr.

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Glenn Schorr - UBS - Analyst

UBS. Okay, so a lot of moving parts, but I will try to stay focused on the key issues of the commercial real estate spin, the current marks and Lehman's capital position after. So let me just check a couple things.

Tier 1 of 11% is as of the end of August. Is that pro forma with the Neuberger gain or not?

Ian Lowitt - Lehman Brothers - CFO

No, that's not pro forma. That's our actual levels at the end of August.

Glenn Schorr - UBS - Analyst

Okay, and then the \$3 billion, it's worded interesting. So I've got to ask the question. The \$3 billion tangible book value benefit, what does it do for total capital in Tier 1? What's Tier 1 pro forma Neuberger sale, or IMD sale?

Ian Lowitt - Lehman Brothers - CFO

Well, I mean with the sale, clearly we remove the goodwill and that improves Tier 1 capital by over \$3 billion. You know, we don't want to speculate on exactly what the proceeds are going to be, but the --

Glenn Schorr - UBS - Analyst

Okay, I don't need the proceeds, I just want to make sure that theoretically if tangible book value benefit is \$3 billion, all else equal your Tier 1 benefits by \$3 billion?

Ian Lowitt - Lehman Brothers - CFO

Yes, and to the extent that there's gains relative to the book value on an after-tax basis, that would increase it. But clearly, you know, all of the indications are that we will be materially -- the bids will be materially above the book value of -- I'm sorry, the goodwill value and as a consequence, minimally what will happen is that you gain over \$3 billion as a result of the goodwill. And there may be additional gains in Tier 1 based on whatever the actual price itself is.

Glenn Schorr - UBS - Analyst

Okay. So it's not a clear one to one, that's for sure.

Ian Lowitt - Lehman Brothers - CFO

Minimally, it clears out the goodwill.

Glenn Schorr - UBS - Analyst

Okay. And I know what the tax basis of what -- at the time of the Neuberger transaction, but can you help us with the tax basis of IMD?



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Ian Lowitt - *Lehman Brothers - CFO*

We would rather not go into that.

Glenn Schorr - *UBS - Analyst*

You'll wait till after the sale? Okay. So then, the REI spin, the marks are -- I'm assuming that there -- there was thoughts about selling all of the commercial real estate assets and that you were exploring all options and you viewed this one better than selling them at whatever the bids came in. But my gut is the bids came in well below the \$0.85 average mark.

Reconcile that difference as that's -- the difference is the equity that you are putting into the spin. So Lehman is putting in somewhere between 5 and \$7.5 billion of equity into the REI spin, if the percentage -- the \$25 billion to \$30 billion times the 20% to 25% equity that you gave us. So is that all equity from Lehman or is any of that third party raised?

Ian Lowitt - *Lehman Brothers - CFO*

Yes, I think that the way we would think about the alternatives with regard to the real estate is maybe a little different than you described it. I mean, if we did try to sell the whole portfolio in a very rapid timeframe, you would clearly pay a very substantial bid/offer spread on that. And the capturing of that value would essentially be value that was retained by the shareholders or whichever the acquiring entity was. By creating the spin, we are obviously shifting the assets off our balance sheets, still to our shareholders, but it's our shareholders that capture that value associated with the disposition of the assets over a period of time, rather than locking in a known loss at this point.

Glenn Schorr - *UBS - Analyst*

I understand, but the way the math looks is if you are going to inject equity to protect REI, and make people feel okay about it, it's the equivalent of a 20%/25%.

Ian Lowitt - *Lehman Brothers - CFO*

So we would in fact be contributing equity in exactly as you are describing. You know, that's in part to -- the level of equity is determined based on what you need to do to support the seller financing, and the amount of equity that we put in as you described, in that sort of range.

Obviously, it's hard to know exactly what the asset levels are likely to be because we will continue to have dispositions and paydowns over the remaining time. But that's sort of the range of it. Clearly we are holding a chunk of equity in our existing Lehman against those exposures. So it's not as though there's a complete -- so that obviously needs to be get factored into how does that play through in terms of the capitalization of core Lehman.

Glenn Schorr - *UBS - Analyst*

I am with you. And then, are you able to tell us, ex-Archstone/SunCal what the average mark is on the rest of the portfolio?

Ian Lowitt - *Lehman Brothers - CFO*

Well, the portfolio is at about 85 and the -- SunCal and Archstone, which were 75 last quarter, have been marked down some amount this quarter.

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Glenn Schorr - UBS - Analyst

Got it. And is the Archstone debt included in this, or is that part of the leverage lending?

Ian Lowitt - Lehman Brothers - CFO

Archstone debt and SunCal debt would be included in the new company.

Glenn Schorr - UBS - Analyst

Okay. And then does it need shareholder approval, the REI spin?

Ian Lowitt - Lehman Brothers - CFO

No.

Glenn Schorr - UBS - Analyst

Okay, and then I guess the biggie after all this, if that equity contribution is being made across to REI and some of it might have been already theoretically in there against those assets, what do you anticipate the capital needs of "good Lehman" or the more de-risked Lehman, post spin? Because obviously you can't fund the 5 to \$7 billion equity injection into REI and maintain your Tier 1 around where it is now.

Ian Lowitt - Lehman Brothers - CFO

No, I think that -- we think that clearly with -- our capital position at the moment is strong. We recognize that with the REI spin we are going to need to put equity into that.

But with the IMD sale and the proceeds associated with that, and the de-risking that goes on, in order to maintain our ratios which is 10 to 12 on the \$300 billion balance sheet, Tier 1 of sort of 11%, we are confident that we can maintain that. So we would in fact be going down some amount of equity as a result of the spin. We will be increasing our equity as a result of IMD.

We will have much less risk on our balance sheet which would allow us to let our leverage drift up from, say, 10.5 times to, say, 12 times which would then leave you with a requirement for leverageable equity around \$25 billion. And in order to maintain the 11% Tier 1 ratio, we will be as a result of the de-risking, bringing down our risk-weighted assets. So we feel that in combination, these things allow us to maintain our strong capital ratios within the construct of the set of things that we're doing now.

Glenn Schorr - UBS - Analyst

Okay. I should end there and let others have a chance. Thank you.

Operator

Michael Hecht.

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Michael Hecht - Banc of America Securities - Analyst

Banc of America. Can you guys help us -- following up on Glenn's question just, I mean book value ended the quarter at 27 and change. So you guys kind of run the numbers on what you think pro forma book value per share would be, post the REI transaction and the IMD transactions?

Ian Lowitt - Lehman Brothers - CFO

I mean, I think that -- lots of things moving around with regard to that. You know, I think that you can compute it in part based on how much equity we are going to shift over to REI and what that is as a share of the total common. And I think on the basis of that you will get pretty close to the number. And then the remainder is obviously in core Lehman.

Michael Hecht - Banc of America Securities - Analyst

Okay. And then I guess, you talked a little bit about the -- well, I guess how should we think about the impact you guys are seeing on the client-facing franchise? I mean, how much of the 20% or so sequential decline that you mentioned some of the run-rate revenues is from the client-facing side versus just some of the cyclical pressures? And then can you touch on the impact you think you are seeing so far in September, especially given the pressure the stock has been under?

Ian Lowitt - Lehman Brothers - CFO

I think that the -- we think that the marketplace itself was sort of seasonally slow in the third quarter, and our estimates of that are in the 10% to 20% range. So we think that -- and the other indications we have don't suggest real share erosion. So we think that broadly our activity is in line with what we think the marketplace has been, and I think that what we're seeing into September is broadly similar.

I think over the last two days, obviously there's been more impact in terms of what's happened with the stock, what's happened with our debt spreads. But we are obviously hopeful that in the description of what our plan is and being clearer about what our quarter is and what we're doing going forward, and what we're planning with regard to IMD, that those stabilize and as a consequence the impact on the client business is more limited. And as a consequence of people getting excited about clean Lehman and the fact that the plan actually separates us from our legacy assets, that we actually do have the platform to really succeed and grow.

Michael Hecht - Banc of America Securities - Analyst

Okay. And then I guess the various issues [thrown] around the firm, can you just talk a little bit about the impact you're seeing on morale, turnover, and then also senior managements relationship with the Board and how management and the Board is currently weighing the cost of staying independent versus maybe selling out to a larger player to help diversify the firms funding mix and maybe restore confidence?

Dick Fuld - Lehman Brothers - Chairman, CEO

Let me talk about that; this is Dick. First on employee morale, clearly we spent a ton of time over these last number of years building a strong, very cohesive culture. As I said in my comments, we've been through adversity before and we always come out a lot stronger.

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It would be foolish for me to say that all of our employees have gone through this period unaffected, because that clearly is not the case. They've been distracted by rumors, they've been distracted a little bit by comments in the press which I mentioned in my comments.

But I will tell you the employees of this firm are holding wonderfully and continuing to do their business day to day in a very strong way, and that culture is holding. As far as turnover, I see no indication of anything that would be abnormal at all. As far as the Board, I'm not sure what you were asking me there. Were you asking me, what is the relationship of (multiple speakers) --?

Michael Hecht - Banc of America Securities - Analyst

Yes, just a little perspective on how they are kind of viewing the various things going on and the different strategic alternatives you guys are weighing including staying independent versus a potential outright sale.

Dick Fuld - Lehman Brothers - Chairman, CEO

Well, we've had a number of board meetings -- some in person, some telephonic -- over the last number of weeks and months. A clear goal was to discuss all of these which we've taken you through today, and all of the strategic options. I must say the Board has been wonderfully supportive, clearly understand and understood each of those options and the implications of each to the Firm.

As far as the last question about a sale of part or all of the Firm, I have always said that, if anybody came with an attractive proposition that made it compelling for shareholder value, that would be brought to the Board, discussed with the Board and evaluated. That has not changed.

Michael Hecht - Banc of America Securities - Analyst

Okay. I just have a follow-up on the investment-management business. I mean, one, just thinking about the sales structure, it seems pretty unique. Can you give us a little more color on how you kind of sell 55% of something but yet kind of retain a majority of the earnings contribution?

Then also, just looking at the flow trends in the asset management business in the quarter, I mean, overall pretty strong but it looked like you had another \$10 million of outflows from money funds after seeing \$11 billion or so last quarter. Obviously not a big revenue deal but I just wanted to get some color on what's going on there.

Then, if you had \$11 billion in inflows overall, it implies some pretty strong inflows in some of the long-term products -- maybe just some color there, too.

Ian Lowitt - Lehman Brothers - CFO

Sure. Yes, I think as you point out, the investment-management business is doing well through this period and on a net basis, we are seeing inflows. You know, there are outflows in the money market product, but to your point, that doesn't have a lot of impact on revenues.

You know, with regard to how this plays through, clearly when you think about the IMD segment, it includes the middle-market institutional business, which we are retaining, the minority stakes, and then it also, if we were going to move forward with this in this form, we would obviously retain our share of whatever the earnings are of the portions of IMD that we are selling off in this form.

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So the combination of those things, retaining two of the revenue streams and earning streams at 100%, and then a little bit less than 50% of the earnings streams that we sell, (inaudible) how the pretax impact of this is the levels that we indicated in the remarks.

You know, the way in which one would essentially establish this is we will have to create a separate entity, which is our IMD business, and then that will have separate governance associated with it. But I think a lot of the value how it integrates into the rest of Lehman Brothers. While that will now be done on a probably more formalized basis with service-level agreements and things of that kind, we are confident that that's the best way to get the most value out of it, both for sort of core Lehman as well as for the investor.

Michael Hecht - Banc of America Securities - Analyst

Okay. Thanks a lot, guys.

Operator

Mike Mayo.

Mike Mayo - Deutsche Bank - Analyst

Deutsche Bank. I have one general question but with some specifics. So, the real issue I'm trying to get my arms around is what are the remaining marks that you have on your real estate exposure? So I guess I will start with the residential real estate. It's down to \$17 billion, and you said it will decline by another \$4 billion with the pending sale to BlackRock. Are the marks for that pending sale in the third-quarter results? If not, what kind of marks might we expect in the fourth quarter?

Bart McDade - Lehman Brothers - President, COO

Mike, it's Bart. A significant amount of the marks for the pending sale have been taken in the third quarter.

Mike Mayo - Deutsche Bank - Analyst

But there's still some in the fourth quarter?

Ian Lowitt - Lehman Brothers - CFO

Yes, there's probably some in the fourth quarter, based on where the final pricing comes out.

Mike Mayo - Deutsche Bank - Analyst

Okay. To what degree have you provided seller financing?

Ian Lowitt - Lehman Brothers - CFO

On the BlackRock transaction, we will be providing seller financing probably at the 75% level. There's cash sweep features that create additional protection for us, but we will be providing seller financing on that transaction.

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Mike Mayo - Deutsche Bank - Analyst

Of the remaining \$13 billion, how aggressive might you be in off-loading that?

Ian Lowitt - Lehman Brothers - CFO

We think that there are a couple of additional trades in Europe that are currently being contemplated, which would reduce that exposure some amount beyond that. But I think we feel our objective is to run this business in and around \$10 billion over a period of time, so we are not anticipating aggressive additional dispositions. Obviously, we will continue to buy and sell assets but that's probably the level that we're hoping to operate at.

Mike Mayo - Deutsche Bank - Analyst

Okay, so residential real estate is mostly where you want it to be with these pending transactions?

Bart McDade - Lehman Brothers - President, COO

That's correct, Mike. I think, if you looked at, and Ian gave you a flavor for the diversification now in the book, it really feels like a set of trading books that [aren't] appropriate size to operate in these markets.

Clearly, we're going to continue to trade out of assets that we see having less value and try to acquire, in the trading activity, assets that, in the flow, assets that have more value. But across the board, US and Europe, it now really looks and feels and is operating as an active trading book.

Mike Mayo - Deutsche Bank - Analyst

So let's just accept what you're saying as absolutely correct. That implies the main issue is the lingering commercial real estate exposure. I appreciate the breakdown, how much it's been marked down in each of the subcategories of residential, but you didn't give us that same breakdown for the commercial real estate exposure. At a minimum, whole loans are two-thirds of the commercial mortgages. How much have those whole loans been written down?

Ian Lowitt - Lehman Brothers - CFO

Well, I think that, last quarter, we said that, within the whole loans, the seniors were in the mid-90s. Now they are sort of in the very low 90s and the mezzanine piece, which was in a very high 80s, is now in a very low 80s.

Mike Mayo - Deutsche Bank - Analyst

Okay. Then more conceptually, why do you need more capital? I mean, I can answer this question, but you said you capital ratios -- tier 1 in total -- are well above the minimums, yet at the same time you are raising tangible equity by \$3 billion. So that implies you need some additional capital.

Is one way to think about this is that the remaining marks on the commercial real estate are maybe \$7 billion, because that's what you need to capitalize REI with?

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Ian Lowitt - *Lehman Brothers - CFO*

No, I think that would be absolutely the wrong way to think about it. The way I think you should think about it is we are basically going to be spinning off a series of assets at much, much lower leverage ratios than the leverage ratios we want to operate with in aggregate. So if we want to operate in aggregate with a leverage ratio of 10 to 12, and then you spin off a chunk of your assets and you're leveraging that at 3 to 4 times, then a consequence of that is you need to or you want to have more tier 1 capital in order to maintain your leverage ratio in that sort of 10 to 12 range rather than have it increased more than that. So I think that's the predominant way to think about that.

Mike Mayo - *Deutsche Bank - Analyst*

Then as a follow-up, to the extent you might need \$7 billion to capitalize that entity, and you'll get \$3 billion with the spin of part of IMD, how would you get the other \$4 billion?

Ian Lowitt - *Lehman Brothers - CFO*

Well, we don't feel that we need to raise that extra amount to cover the \$7 billion, because you will have less sort of leverageable equity in core Lehman than in, you know, where you are at the end of this quarter. So at the end of this quarter we are at 29.5, basically, of leverageable capital.

The amount that you need in the remaining core Lehman, given that it has \$300 billion of assets and you're going to lever at, say, 12 to 1, is only sort of 25 times. So you could actually have your leverageable equity come down some amount and have the \$5 billion to \$7 billion sitting in the real estate entity and still be well-capitalized within sort of the remaining core Lehman.

Mike Mayo - *Deutsche Bank - Analyst*

Last question -- it will be debated on probably many phone calls today, but what last statement can you say to give comfort that there aren't major additional marks in the commercial real estate before the transfer -- before the REI spin? Dick, maybe you can respond to that, because this is I think that is the issue right now.

Dick Fuld - *Lehman Brothers - Chairman, CEO*

You're talking about strictly the commercial real estate?

Mike Mayo - *Deutsche Bank - Analyst*

Yes, just commercial real estate.

Dick Fuld - *Lehman Brothers - Chairman, CEO*

We had a number of sales this last quarter, and it's been a very hard -- I think actually Ian spoke about it -- a very hard stress analysis at the losses though that we did incur were more limited and driven in part to the increase in yield expectations among investors. We do not envision large write-downs in the commercial real estate portfolio, given the current market.

Mike Mayo - *Deutsche Bank - Analyst*

But the CMBX declined a lot this quarter. Can you help reconcile the two thoughts?

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Ian Lowitt - *Lehman Brothers - CFO*

I think CMBX actually tightened a lot last quarter, and there were no gains associated with it is our portfolio is almost exclusively floating-rate. So there's really no real impact on our real estate position as a result of the CMBX. I think that clearly there's an enormous amount of attention from -- in our auditors and others around our marks with regard to the real estate. You know, as we spin it off, we're going to be filing of Form 10, we're going to have the audited balance sheet associated with that.

To Dick's point, we sold a lot of real estate last quarter and this quarter, and our sales are in and around our marks, which again gives us comfort that, even in a difficult environment where people are looking to take advantage of the fact that we are obviously looking to reduce our exposure quite quickly, the fact that we are selling in and around our marks over many, many billions of dollars of transactions and many, many different accounts and many, many different positions, that again gives us comfort that the marks that we maintain and the levels at which we will be transferring these assets into the new entity are essentially the right levels.

Mike Mayo - *Deutsche Bank - Analyst*

Okay, that's helpful. Thank you.

Operator

Douglas Sipkin.

Douglas Sipkin - *Wachovia Securities - Analyst*

Wachovia. Just one follow-up on some of the discussion, and then just a general comment about the recent government activity. I'm just trying to understand the book value implications for the spin into the commercial business. I know a couple of other analysts have highlighted about \$6 billion to \$7 billion in equity basically transferring over in. I mean, is there going to be a significant book value implication from this transfer? I'm just not clear on that.

Ian Lowitt - *Lehman Brothers - CFO*

I think we would say that, if it was the \$6 billion to \$7 billion, it would be \$6 billion to \$7 billion out of the \$19 billion of tangible book that we actually operate with, and that would give you a way to split the book value that we think goes into the new entity and the book value that remains.

Douglas Sipkin - *Wachovia Securities - Analyst*

So you've identified \$3 billion of I guess essentially goodwill coming back, because you're selling a majority stake in Neuberger Berman, but that doesn't account for any potential gain that might exist. Is that correct?

Ian Lowitt - *Lehman Brothers - CFO*

That is correct.

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Douglas Sipkin - Wachovia Securities - Analyst

So arguably, that \$3 billion could be, depending upon the pricing -- I mean, a considerable amount higher I would imagine, even though it's probably a challenging environment to sell a piece of an asset-management business, the AUM level is substantially higher from when you first bought it. Isn't that correct?

Ian Lowitt - Lehman Brothers - CFO

Exactly right, so I think you're thinking about it exactly the right way.

Douglas Sipkin - Wachovia Securities - Analyst

Then just a general question, and I know it's kind of early into the government action over the weekend. What are your views on the impact that's going to have on your business? Have you seen any tangible impact of that already? I know agency spreads have rallied. Just generally speaking, what do you think that can potentially do over the next three to six months to the mortgage markets?

Bart McDade - Lehman Brothers - President, COO

Doug, it's Bart. I think we would argue the event itself was extremely constructive from a point of view of both the specific actions around the capital market's affect on the capital structure of Fannie and Freddie, but as significantly, the notion of and the actions of the treasury to move into using the balance sheet and actually acquire mortgage assets we thought was equally impactful. So we were very constructive. We have held a number of research calls in from the risk side. We are very constructive. That was a very significant event, not only for the companies but for the markets as a whole.

To answer your question what's happened, a lot of market experts have seen it; we've seen a change in positive psychology, a slight improvement. We were not expecting that it would be an over-night affect, but over time, the impact, the positive impact of both of the events we think does lead to more constructive and more liquid markets, which is what we all need.

Douglas Sipkin - Wachovia Securities - Analyst

Then just a follow-up, I mean, obviously, there's a pretty substantial backlog of debt that needs to get refinanced. Any view as to when maybe that business can start to open up again? It's possible this action helps, or any viewpoint as to when it may come or does it just require a little bit better tone around the economy?

Bart McDade - Lehman Brothers - President, COO

I think, if you're speaking to -- you are speaking to the securitized markets or you're speaking (multiple speakers)?

Douglas Sipkin - Wachovia Securities - Analyst

No, no, like just debt finance -- I mean you guys always talk about there's a huge backlog of refinancing and there's a lot of money on the sidelines. I'm just talking sort of corporate debt.

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Ian Lowitt - *Lehman Brothers - CFO*

We think it's obviously helpful at some level, but I think that more stabilization is probably necessary to be able to address what's already a lot of buildup.

Douglas Sipkin - *Wachovia Securities - Analyst*

Great, thanks.

Operator

Bill Tanona.

Bill Tanona - *Goldman Sachs - Analyst*

Goldman Sachs. Good morning. I guess the first question is are you guys providing financing for the investment management sale?

Ian Lowitt - *Lehman Brothers - CFO*

You know, we are expecting bids back very, very soon, and we will see, as a result of what comes back, whether that's necessary, but it's not currently anticipated.

Bill Tanona - *Goldman Sachs - Analyst*

Okay. Then I guess, in terms of understanding, I know somebody else had already asked the question but I guess I just don't understand the financial impact of the sale. Will this still be consolidated, considering that you are retaining the majority of the pretax income, or how should we think about the revenue impact as a result of this sale? Because I just don't understand how you guys can sell 55% yet retain the vast majority of the pretax income.

Ian Lowitt - *Lehman Brothers - CFO*

No, I think you are right that we would not be consolidating, and I think that maybe I can clarify on this question sort of what's happening there.

It's actually, you take the whole segment and divide it into a piece that's being sold and a piece that isn't. The piece that isn't being sold obviously just stays inside Lehman Brothers and gets incorporated in predominantly into our Capital Market segment.

For the piece that we are selling, we won't be consolidating that, and that represents a small piece of the earnings but actually a larger fraction of the revenues. So we think that the revenue impacts might be quite a bit larger in that sense, but that the pretax effect is more muted in part because the margins on the pieces that we're selling are lower than the margins on the pieces that we're keeping, and then, of the pieces that we're selling, we're still going to retain 45% to 49% of those earnings.

Bill Tanona - *Goldman Sachs - Analyst*

Okay. I guess, taking that a step further in terms of thinking about the run rate that you guys provided, exit these write-downs this quarter at \$3.5 billion, what would be kind of the run rate pro forma for this sale of the investment-management division

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as well as the transfer of the assets to the new co., considering that was I guess \$5 billion of cash flow a year that you guys had indicated?

Ian Lowitt - *Lehman Brothers - CFO*

Yes, we think that 2008, excluding the marks and excluding our IMD, the run rate, pre the debt valuation, is 14.6, so that includes the earlier time periods. But essentially what we're forecasting for next year is a little bit lower than what we've had for the full year, but it's obviously in line with what we have for the last two quarters.

Bill Tanona - *Goldman Sachs - Analyst*

But does that exclude the cash flows from the spinoff of the new co.? Because I'm trying to understand that \$5 billion in cash flow and the paydown in debt being reduced to 50-50 over the course of four years and the impact that might have on the revenues as well.

Ian Lowitt - *Lehman Brothers - CFO*

Yes. Actually, what we're doing with a lot of the cash flow that comes in is using it to just mark down the bases, so the impact on our revenues of that is not significant. A lot of the reduction in our commercial positions is coming down as a result of sort of paydowns. So part of the reduction this quarter is the result of paydowns. They don't go into revenue; they just enable you to reduce your balances within commercial. So that was between \$1.5 billion and \$2 billion this quarter.

So the run rate that we are seeing of sort of paydowns is actually consistent with what's forecast from a cash flow perspective going forward.

Bill Tanona - *Goldman Sachs - Analyst*

Okay. Then in terms of there's a lot of questions on the marks of the portfolio. Will there be an independent firm that actually verifies the value at which these commercial real estate assets are actually being put into this new hold co.?

Ian Lowitt - *Lehman Brothers - CFO*

There will be audited financials as part of the Form 10 filing.

Bill Tanona - *Goldman Sachs - Analyst*

Okay. Then just lastly, in terms of buying shares, you look at the stock trading right now at about a third of book value; it has been for a while. We really haven't seen much in the way of senior executives buying the stock. I assume part of that is because of your involvement around some of these transactions. I guess, going ahead, what is it going to take to kind of see some of the senior executives purchasing stock down here as a sign of confidence?

Ian Lowitt - *Lehman Brothers - CFO*

Yes, I think the reason is obviously there's been a great deal of nonpublic and material information which has precluded any of our senior executives from buying any stock. We also have not been using the Firm's capital to go into the marketplace and buy stock because we feel that preserving capital in this environment is the most important thing that we can actually do. So, I think that's really all of the dynamics around the stock.

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Bill Tanona - *Goldman Sachs - Analyst*

I guess, going forward, what would it take to get senior executives to be purchasing stock?

Ian Lowitt - *Lehman Brothers - CFO*

I think we need to be in a circumstance where there isn't any nonmaterial public information that is precluding us from doing that.

Bill Tanona - *Goldman Sachs - Analyst*

Okay, thanks.

Ian Lowitt - *Lehman Brothers - CFO*

I think we have time for just one more question, because we wanted to conclude this before the markets actually open.

Operator

Our last question comes from Guy Moszkowski. Please state your company name.

Guy Moszkowski - *Merrill Lynch - Analyst*

I'm with Merrill Lynch. Is it correct to assume that REI will be structured as a REIT? And is that why it won't be subject to mark to market?

Ian Lowitt - *Lehman Brothers - CFO*

It's not going to be structured as a REIT, and it won't be subject to mark to market because it's going to be just on a held-to-maturity basis and the discussions that we've had have confirmed that that's the way in which it will be treated.

Guy Moszkowski - *Merrill Lynch - Analyst*

Okay. Just switching to IMD, is there something contemplated in the way this will be structured which will enhance the retention of IMD personnel?

Ian Lowitt - *Lehman Brothers - CFO*

I think the retention of IMD folks is a critical element of the structuring, so that's something that both we and whoever the acquirer is would be very, very attentive to.

Guy Moszkowski - *Merrill Lynch - Analyst*

So presumably that will be included in the economics and would probably affect the price to some extent?

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Ian Lowitt - *Lehman Brothers - CFO*

Yes.

Guy Moszkowski - *Merrill Lynch - Analyst*

Has there been any change in how you calculate your debt valuation gains in the quarter? Because for the period up to the end of August, we couldn't see a degree of spread widening in your debt that was commensurate with the scale of the gain.

Ian Lowitt - *Lehman Brothers - CFO*

Yes, I think we mark off the cash curves in the US and also in Europe for the European debt. We could certainly show you those numbers.

Guy Moszkowski - *Merrill Lynch - Analyst*

Okay, that might be helpful. Maybe I will follow-up later.

Then finally, with the big spinoff of the CRE assets, and you did talk about generally rightsizing businesses internally, can you give us a sense of how you are sizing personnel and capital commitment of that business going forward, relative to kind of the run rates of commercial real estate over the last couple of years?

Ian Lowitt - *Lehman Brothers - CFO*

Sure. I think we're looking to migrate that business from, you know, to one which is much, much more focused on advice and restructuring advice. To the extent that there is sort of investment within the business that would be done really through the private equity investment funds, not on balance sheet. So I think that is the principle ways in which we are thinking of restructuring that business.

Guy Moszkowski - *Merrill Lynch - Analyst*

Okay, that's helpful. Thank you very much. Thanks for doing the call this morning.

Ian Lowitt - *Lehman Brothers - CFO*

Well, thank you all for joining us on short notice. Obviously, there were a lot of questions; we got through a lot of important stuff. I'm sure there will be follow-up questions that you and others have. We are obviously ready to deal with those questions and at your disposal. We would like to close by thanking our clients, our employees, our investors and our counterparties for standing with us.

Operator

That concludes today's call. Thank you for participating. You may now disconnect your line.

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TAB 34

From: [Rita C Proctor](#)
To: [Rita C Proctor](#)
Cc: [Brian F Madigan](#); [Cecelia M Bradshaw](#); [Donald L Kohn](#); [Julie Edwards](#); [Kevin Warsh](#); [Margaret Owens](#); [Marie L Spicer](#); [Michelle A Smith](#); [Patrick M Parkinson](#); [Rivane V Bowden](#); [Scott Alvarez](#); [Valerie Delaney](#); [Yvette K McKnight-Johnson](#)
Subject: Conference Call -- Wednesday, 9/10/08 @ 8:30 a.m.
Date: 09/09/2008 07:37 PM

Wednesday, September 10, 2008

08:30 AM - 09:30 AM Conference Call [re: Lehman Brothers]

Location: Chairman's Office

Principals: Secy. Cox, Chairman Bernanke, Vice Chairman Kohn, Governor Warsh & President Geithner

Board Staff: Scott Alvarez, Brian Madigan, Pat Parkinson & Michelle Smith

FRB NY Staff: Arthur Angulo, Thomas Baxter & William Rutledge

Conference bridge information:

Toll Free Dial In Number:


Participant Code:

Int'l Access/Caller Paid Dial In Number:

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TAB 35



From: Rutherford, Matthew
Sent: Wednesday, September 10, 2008 11:49 AM
To: Ryan, Tony; Norton, Jeremiah; Shafran, Steven; Kashkari, Neel; Jester, Dan (Contractor); Via, Stafford; Foley, Trip; Stoltzfoos, Jeffrey; McCormick, David; Renander, Sonja; Lowery, Clay; Franco, Jamie; Sobel, Mark; Ramanathan, Karthik; Wilson, Ken (Contractor); Davis, Michele; Pedroni, Michael; Dulaney, Tim; Hong, Austin; Leary, Megan; Burke, Brendan; Wilkinson, Jim; Frame, Scott; Zuccarelli, Jennifer; Cvitan, Sandra; Murden, Bill; Swagel, Phillip; Wheeler, Seth
Subject: Money Funds & Lehman

Below is some color on money fund willingness to fund Lehman from FRBNY. Please keep very close to home.

Key takeaway: lots of concern and reassessment of exposure, although we have not seen a wholesale pull back of lines.

I've spoken to several large money funds this morning and have received somewhat mixed reports in terms of new shifts in providing funding to Lehman. As background, over recent months, funds have gradually reduced their exposures to Lehman, by reducing or eliminating unsecured positions, by reducing the tenors and amounts of secured positions, and in some cases narrowing the types of collateral accepted for secured lending. In many cases, the only remaining exposures were overnight repo for traditional (Fed OMO-eligible) collateral. Today, of the funds I have spoken with thus far, all but one were continuing to roll overnight repo for steady amounts. One fund did not roll about \$1.5 billion in overnight positions for Treasury and agency-MBS repo. They stressed that they saw negligible risk in maintaining these positions, but found it easiest to eliminate the exposure in the face of inquiries from investors and senior management. Another fund, which had maintained small overnight unsecured positions did not roll these today. Additionally, some tax-free funds which hold structured municipal products for which Lehman is the liquidity provider were exercising put options to reduce these positions. Importantly, Fidelity, the largest fund complex, stressed that while they hadn't made any significant shifts yet today, they were still in the process of making decisions and wanted to update me later in the day, so more to follow...

TAB 36



Mark VanDerWeide/BOARD/FRS

09/10/2008 05:17 PM

To Scott Alvarez/BOARD/FRS@BOARD
cc
Subject lehman

At 4:15pm FRBNY/Board call, same three options were laid out once again by Tim. Working groups were directed to spend the next few hours fleshing out how a Fed-assisted BofA acquisition transaction might look, how a private consortium of preferred equity investors transaction might look, and how a Fed take out of tri-party repo lenders would look. Reconvening for a 7pm call to discuss again.

At Pat Parkinson's request, I am trying to insert myself into the Fed-assisted acquisition transaction discussions, but no success yet.

There are definitely a number of legal issues associated with each option, which we will need to focus on before too much more time goes by. I am compiling a list.

Tim seemed to think that Lehman would survive into the weekend, but may need some PDCF help tomorrow or Friday.

Mark

TAB 37

From: Patrick.M.Parkinson@frb.gov
To: [Don Kohn](#); [Scott Alvarez](#); [Brian Madigan](#)
Subject: Fw: revised Liquidation Consortium gameplan + questions
Date: 09/11/2008 06:55 AM
Attachments: [LEGALDOCS-#283188-v1-9_10.DOC](#)

From: Michael.Nelson
Sent: 09/10/2008 10:59 PM AST
To: Christine Cumming; Terrence Checki; Jamie McAndrews; Thomas Baxter; Chris McCurdy; Dianne Dobbek; William BRODOWS; Brian Peters; William Dudley; Michael Schetzel; Patrick Parkinson
Subject: revised Liquidation Consortium gameplan + questions



[- LEGALDOCS-#283188-v1-9_10.DOC](#)

Liquidation Consortium

I. Rationale

- To convene in one room senior-level representatives of major bank and investment bank counterparties of Lehman -- most notably in tri-party repo, credit-default swaps, and other OTC derivatives – who we feel would be most adversely affected by a Lehman insolvency.
- To provide a forum where these firms can explore possibilities of joint funding mechanisms that avert Lehman's insolvency.

II. Possible Consortium Members

Banks and Investment Banks with exposures from loans,
OTC derivatives, tri-party repo:

Bank of America
Barclays
Citi
Credit Suisse
Deutsche
Goldman
JPMC
Merrill
Morgan Stanley
RBS

Other affected parties

BONY
State Street

- Goal would be to invite institutions that will stay at the table. If one leaves, many more may follow

III. Logistics

- First meeting must occur, at the very latest, Friday at the close of business New York time. If we perceive that the current potential bids for Lehman are unlikely to materialize, we should move the meeting up and consider holding it on Thursday.
- Very little advance time given to participants – 2 hours max – to minimize risk of outside leaks.

- Exception: we should immediately indicate to current and potential sole bidders for Lehman that we are planning to convene a consortium that will include them and other market participants no later than Friday.
- Invitations by phone – inviting the CEO and one other participant. Invitees are told that they should have the authority to bind their firms but are not in advance told the identity of the other firms to be represented at the table.
- FRBNY to host. Paulson delivers introductory remarks (we script) and Treasury and FR staff recede to background to provide passive mediation at most. Lawyer present to provide antitrust protections.
- Lehman senior staff (not Fuld) in a separate room, available to provide information if necessary. Lehman must also be prepared to open its books to representatives of the consortium as early as Friday night.
- Participants told by Paulson that they have until opening of business in Asia (Sunday night NY time) to explore whether they can jointly come up with a credible plan to recapitalize Lehman to an extent necessary to enable an orderly winding down. Paulson conveys willingness of the official sector to let Lehman fail.
- FRBNY starts to communicate with foreign supervisors while meeting is taking place.
- We would expect consortium members to break and reconvene for a period of up to 48 hours, in addition to sending a consortium team to Lehman for due diligence.

IV. FRBNY financial commitment (this section expected to be overhauled by Dudley, Schetzel)

- We should have in mind a maximum number of how much we are willing to finance before the meeting starts, but not divulge our willingness to do so to the consortium.
- Term of any liquidity support should be long enough to guard against a fire sale, but on a short enough fuse to encourage buyers of Lehman assets to come forward. Two months to a year in duration?
- Preferable to style FRBNY commitment as much as possible as a backstop rather than lending, but we can't attach too much of a subsidy to liquidity, or the consortium will not have sufficient incentives to act.

V. Consortium commitments

- We will put forth at the meeting how much we think Lehman needs in terms of an infusion. We assume that members of the

consortium will not pull business from Lehman going forward, which may decrease the amount of support needed.

- Consortium members will incur other costs – seconding their staff to work at Lehman starting immediately.
 - Lehman is bigger and more global than Bear Stearns, so the consortium will have to address in short order the question of how to establish control at Lehman offices outside New York.

VI. Sunday Night Statements

- Consortium will have to come up with a statement to the financial markets on Sunday night, if they can come to material agreement on a sufficient plan.
- Treasury, FR may wish to issue statements on Sunday as well. FR will want to discuss any new liquidity facility that has been created to provide a backstop to the consortium.

VII. Open Issues

- Legal
 - Approval of current Lehman shareholders – what would a takeover by the consortium require, and can it be obtained easily?
 - Regulatory approvals – what would be necessary worldwide, and with what time constraints/considerations? (Presumably FR could help facilitate.)
 - Is the consortium vulnerable to attempts by nonconsortium members to take Lehman into involuntary bankruptcy, including in jurisdictions outside of the United States?
 - Can we obtain necessary FOMC approval for whatever funding facility is fashioned to facilitate a consortium?
 - What type of capital or other regulatory relief should/must we provide for members of the consortium?
- Governance
 - Can the consortium come to sufficient agreement on how to manage Lehman, at least in the short term (next two weeks) by late Sunday afternoon? Will 2-3 firms emerge as leaders willing to shoulder the administrative burdens by, for example, seconding staff to Lehman?
 - Does Fuld have to be replaced on Sunday? If so, do we exercise influence over the choice of his successor?

- To what extent does FRBNY become involved, or mired, in disputes between the consortium members after Sunday?

- Ratings Agencies
 - When do we expect the consortium to approach the ratings agencies, and to what extent do we engage in discussions with the ratings agencies over FR liquidity we expect to provide to the consortium?
- Communications
 - Do we have any chance of keeping the initial and ongoing meetings of the consortium on Friday and over the weekend confidential? How do we get the consortium members – and Paulson – into the building without alerting the press?
 - Which foreign authorities do we inform about the initial meeting of the consortium? Are there other official bodies whom we inform before a statement is made to the public -- either inside or outside the United States?
 - What are the bare minimum elements of the Sunday night statements – by the consortium, by Lehman, by FR, by Treasury – that will provide sufficient, immediate comfort to the financial markets?
 - When and how do inform key Members of Congress?
- Financial capital
 - How do we best hone in on the monetary figure we think the consortium will have to provide in new capital and the type/maximum amount of any FR financing to support the consortium? What is the deadline for finalizing these numbers, and what further financial information do we require?
 - Does this new financial commitment put a material strain on consortium members?
 - Are current compensation commitments by Lehman (for example, bonus accruals) – which presumably survive takeover by the consortium – unduly onerous?
- Human capital
 - How can the consortium retain key Lehman staff?
- Longer-term planning
 - It is recognized that much of Lehman will disappear in relatively short order. For financial stability purposes, will we want to shorten, lengthen, or otherwise manage that process through the consortium?
 - When would we expect to wind down any FR liquidity facility that supports the consortium, and to what extent must/should we state this publicly?

TAB 38

From: [Mccabe, Susan L](#)
To: william.dudley@ny.frb.org; gustavo.a.suarez@frb.gov; Chris.Burke@ny.frb.org
Subject: Hope you have the Radar screens on early this morning:
Date: 09/11/2008 08:26 AM

It is not pretty, This is getting pretty scary and ugly again. Analysts, WSJ, CNBC all piling on talking about disappointment with LEH plan(wish they would stop), LEH is trading pre-open in a "4" handle our equity hoot is saying, their CDS out to 715 area last I heard. They have much bigger counter-party risk than Bear did, especially in Derivatives market, so the market is getting very spooked, nervous. Also have Aig, Wamu concerns. This is just spinning out of control again. Just fyi, this is shaping up as going to be a rough day.

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TAB 39

[REDACTED]

From: Rutherford, Matthew
Sent: Thursday, September 11, 2008 10:35 AM
To: McCormick, David
Cc: Ryan, Tony; Wilson, Ken (Contractor)
Subject: Fw: leh color

Fyi

From: Hayley.Boesky@ny.frb.org
To: Meg.McConnell@ny.frb.org ; William.Dudley@ny.frb.org ; Patricia.Mosser@ny.frb.org ; Brian.Peters@ny.frb.org ; Michael.Nelson@ny.frb.org ; Debby.Perelmutter@ny.frb.org ; Schetzel, Michael; Rutherford, Matthew
Sent: Thu Sep 11 10:32:53 2008
Subject: leh color

Head of FI sales at Lehman just called me to let me know:

- counterparty volumes are EXTREMELY low, some trades being done but low, low, low
- he has received a handful of requests for unwinds but, as far as he knows, no problems in others taking Leh credit in broker market
- His buddies at Barclays and Citi have received a handful of inquiries to intermediate. they have agreed to do so but at a cost.
- he has not heard of any denials of novations
- PB business is losing balances
- FI desk is funded through tomorrow
- Leh employees and clients all understand this is close to the end game, but they are not experiencing a full blown run

Hayley R. Boesky
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Telephone: [REDACTED]

Mobile: [REDACTED]

TAB 40

From: [Rita C Proctor](#)
To: Chairman
Subject: Fw: AMFinancial Markets Conference Call 9/11/08
Date: 09/11/2008 10:45 AM

RESTRICTED FOMC CLASS II

Overnight, sentiment towards risky assets remains decidedly negative as market participants continued to discuss the Lehman Brothers announcement yesterday. In particular, overseas equities, particularly in Asia, were off as much as 3 percent overnight, while U.S equity futures were down 1.4 percent. Again, financial sectors underperformed, with the Topix banking sector index 5 percent lower. In addition Treasury yields were 8 basis points lower and the dollar continued to appreciate against most major currencies. The yen also outperformed against most higher yielding currencies.

For the most part, analysts have continued to express disappointment that Lehman Brothers has yet to make significant progress in actually obtaining additional capital. Some market participants have been comparing the "feeling" in the market with that just ahead of Bear Stearns in March.

Because of the ongoing focus on Lehman, there has been a great deal of focus on the potential implications of a downgrade (or worse) could have on financial markets.

Lehman's share price declined 45 percent to \$4 in the pre-open and its CDS price widened 200 basis points to 775 as market participants voiced concern over the viability of Lehman as an ongoing concern. Yesterday afternoon, Moody's held a conference call on this topic and stated that Lehman's plan for reorganization was insufficient for them to maintain their current 'A2' credit rating and -- without additional shoring up of their capital base, preferably by a strategic buyer with substantial capacity -- Moody's would likely downgrade Lehman's long-term credit rating. Moody's cited the market's "crisis of confidence" concern with Lehman to suggest that ratings downgrades could come quickly unless there was swift progress to shoring up Lehman's capital base. There are several possible implications of a Lehman downgrade:

1. Lehman would have to post collateral to many of its over-the-counter derivative counterparties, which could put further strain on its funding needs. One dealer estimates that a one notch downgrade of Lehman could require them to post \$2.9 billion of collateral, and a 2 notch downgrade could require \$4.4 billion of collateral.
2. In addition, funding from money funds are likely to be adversely impacted by a ratings downgrade. We've spoken with several large money funds since Lehman's preannouncement and have received somewhat mixed reports in terms of new shifts in providing funding to Lehman. Of the funds that we have spoken with thus far, all but one were continuing to roll overnight repo for steady amounts. One fund did not roll about \$1.5 billion in overnight positions for Treasury and agency-MBS repo. They stressed that they saw negligible risk in maintaining these positions, but found it easiest to eliminate the exposure in the face of inquiries from investors and senior management. Another fund, which had maintained small overnight unsecured positions did not roll these yesterday. Importantly, Fidelity, the largest fund

complex, stressed that while they hadn't made any significant shifts yet today, they were still in the process of making decisions and would follow up with us later.

As background, over recent months, funds have gradually reduced their exposures to Lehman, by reducing or eliminating unsecured positions, by reducing the tenors and amounts of secured positions, and in some cases narrowing the types of collateral accepted for secured lending. In many cases, the only remaining exposures were overnight repo for traditional (Fed OMO-eligible) collateral.

As such, some believe that Lehman is currently in a distressed sale situation, and it is not completely clear who would or could buy the firm. Some suggest that Lehman Brothers' most viable option is to find a highly rated, deep-pocketed buyer. Some suggest that this might mean it could be a large bank, though they note that two of the largest U.S. banks may not currently have the capacity to acquire Lehman and its assets. JPMorgan is still digesting Bear Stearns and Bank of America is still working through their Countrywide acquisition. Thus, some have suggested that a consortium of banks could take on this role. Other potential candidates are sovereign wealth funds or private equity firms. However, some suggest that the size of a potential capital injection may be large enough to require some type of federal approval for a sovereign fund to inject capital, which would lengthen the duration of the process and may deter some potential suitors.

In many ways, if Lehman were to fail, it would be a much more complex proposition to unwind their positions than it would have been to unwind the positions held by Bear Stearns. At the end of 2007, Lehman's net positions in derivatives measured approximately \$54 billion, or nearly twice the size of Bear Stearns at that time. While Lehman's management has taken significant steps to reduce these positions and de-risk Lehman's balance sheets, it is likely that a failure by Lehman would be significant. With sentiment towards Lehman appearing to shift, market participants have also started to discuss the implications for other broker dealers and the financial system as a whole. The CDS term structures of other broker dealers have inverted further. Assuming recovery values of 40%, the market is placing a 5% probability that Morgan Stanley defaults in the next year and a 7% probability that Merrill Lynch defaults.

In addition, some market participants suggest that a further deterioration in risk sentiment due to a worst-case scenario with Lehman Brothers could have an impact on the risk positions of hedge funds. As we noted yesterday, this may push more hedge funds towards their NAV triggers. Hedge funds' poor performance and investor redemptions are also behind some recent concerns regarding the strength of Goldman Sachs' prime brokerage business. Several market participants have speculated that the prime brokerage business may be suffering as a result of the closure of a significant number of clearing accounts, and that these accounts may be under-margined, requiring Goldman to make up the difference. Goldman's share price is 3 percent lower on the session and their CDS spreads have widened 10 basis points to a level of 182 basis points.

Pressures in the funding markets

Redacted Materials

markets to persist in coming months. Spreads 6-months forward and beyond have also risen notably over the intermeeting period.

Rates in collateralized funding markets Redacted Materials

Jason Miu
Markets Group
Federal Reserve Bank of New York
(212) 720-6860

TAB 41

[REDACTED]

From: Rutherford, Matthew
Sent: Friday, September 12, 2008 8:01 AM
To: Wilkinson, Jim
Subject: Market Sentiment

See the email below. I would be careful about any statement. Markets are incredibly nervous.

-----Original Message-----

From: Hayley.Boesky@ny.frb.org [mailto:Hayley.Boesky@ny.frb.org]
Sent: Thursday, September 11, 2008 11:58 PM
To: Hayley.Boesky@ny.frb.org
Cc: Brian.Peters@ny.frb.org; Debby.Perelmutter@ny.frb.org; James.Clark@ny.frb.org; Matthew.Lieber@ny.frb.org; Rutherford, Matthew; Meg.McConnell@ny.frb.org; Michael.Nelson@ny.frb.org; Schetzel, Michael; Patricia.Mosser@ny.frb.org; Steven.Friedman@ny.frb.org; William.Dudley@ny.frb.org
Subject: Panic

I have spent the past 3 hours receiving calls from HFs. On a scale of 1 to 10, where 10 is Bear-Stearns-week-panic, I would put sentiment today at a 12.

People are expecting full blown recession. There is full expectation that Leh goes, wamu and then ML. Worries about GS and reports of losses in their PB business. Apparently GS had a lot of commodity HFs who took big losses. ALL begging, pleading for a large scale solution which spans beyond just LEH. The two ideas which keep coming up are easing risk capital weights and a RTC type fund. Objective is to ease balance sheet pressures of the banks.

I am sure you have all heard lots of this but I felt I needed to relay the message given they all took the time to call and given the panic in their voices...

----- Original Message -----

From: Hayley Boesky
Sent: 09/11/2008 11:36 AM EDT
To: Hayley Boesky
Cc: Brian Peters; Debby Perelmutter; James Clark; Matthew Lieber; Matthew.Rutherford@do.treas.gov; Meg McConnell; Michael Nelson; Michael Schetzel; Patricia Mosser; Steven Friedman; William Dudley
Subject: Re: Fw: Options for short-circuiting the market nearly every large HF (Moore Cap, Tudor, Fortress, etc.) has called to tell me that others are refusing to take LEH's name

Hayley R. Boesky
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Telephone: [REDACTED]

Mobile: [REDACTED]

Hayley
Boesky/NY/FRS

To

09/11/2008 10:46
AM

Meg McConnell/NY/FRS, Bill Dudley,
Patricia Mosser/NY/FRS, Brian
Peters/NY/FRS, Michael
Nelson/NY/FRS, Debby Perelmuter,
Michael Schetzel/NY/FRS,
Matthew.Rutherford@do.treas.gov
cc
steven.friedman@ny.frb.org, James G
Clark/NY/FRS@FRS, Matthew
Lieber/NY/FRS@FRS
Subject
FW: Options for short-circuiting
the market

some thots from Louis. I have bolded the relevant points.

Hayley R. Boesky
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Telephone: [REDACTED]

Mobile: [REDACTED]

----- Forwarded by Hayley Boesky/NY/FRS on 09/11/2008 10:08 AM -----

"Louis Bacon"
[REDACTED]

09/11/2008 09:10
AM

<Hayley.Boesky@ny.frb.org>

To

cc

Subject
FW: Options for short-circuiting the
market

Our thoughts as of earlier.

On a day like this it make sense to make a quick list of what the Fed and/or Treasury can do tomorrow/at any point to try to short circuit what is going on in the markets. To be clear - I do not have any specific intelligence on how any of these are being considered by policymakers. This is only to lay out what is legally possible. All of the items on this first list are entirely achievable by either Treasury or the Fed without any need to consult with or seek authority from Congress

The Fed can cut rates - either on the 16th or intermeeting. They have at least 150bps of ease without getting us into Japan territory. FOMC as a group could not accept the tradeoff on inflation for a FF rate lower than 2.00%. The last cut was April 30th. Crude was at \$113. In the interim, the markets and the economy got worse (worse than the Fed had expected), and crude went to \$145. Crude is at \$103. Going forward, inflation is only going to go one way - South. The Fed should seriously consider cutting.

The Treasury can announce a large GSE MBS purchase program under their GSE support package from this weekend. They were hoping for a big positive bounce from the GSE package and announcement and I suspect they were waiting to see if they could get away with something small. If it made sense to cross the threshold to have the US purchase GSE MBS in the first place, then the Treasury should announce a big number that will make the market think again (positively) about the value of any GSE MBS banks hold. All the critiques of this weekend's GSE plan will still apply (it doesn't fix the problems with the bad assets/private-label MBS, HELOCS, underwater borrowers, unemployment), but this is a step that Treasury has all the authority it needs to take immediately and which they should take in conjunction with a Fed move.

The Treasury can announce a major expansion of funding to the Federal Home Loan Bank system. This would be passed on to banks via a major expansion of advances from the Federal Home Loan Banks against mortgage-related collateral, including term advances of up to three years. This would be out of left field, but Treasury already has all the legal authority and all the budget authority it would need to do this. (Treasury somewhat-unexpectedly asked for the authority to support the FHLBs, along with the authorities they used in this weekend's GSE package, in the July legislation.) Treasury may be positioning for something of the sort - this weekend, when they announced the new Treasury credit facility for the GSEs (Government Sponsored Enterprise Credit Facility), they opened the credit facility to the FHLBs as well as to Fannie & Freddie. The FHLBs can borrow from this new Treasury credit facility at Libor+50 by pledging advances that the FHLBs make to banks. This is intended to be short term credit facility, with loan terms from one week to one month, renewable. But if Treasury wanted to crank up a major Treasury lending program for the FHLBs and make the loans long-term, it could allow the FHLBs to provide even more significant term funding at predictable rates to banks for their mortgage-related assets including HELOCS, whole loans, etc.

Bank regulators can cut risk weightings on GSE-issued MBS and debt on the basis that the government has backstopped the Agencies. This would free up balance sheet and help with the capital problems at banks. The one stumbling block to this is that the Treasury included an explicit "Disclaimer of Guarantee" in their \$100B backstop agreement with the GSEs this weekend. This states clearly that Treasury's commitment "shall not be deemed to constitute a guarantee" by the United States of the payment or performance of any debt security of the GSEs. So, Treasury converted the implicit guarantee into an explicit contingent liability of the USG for the express benefit of the GSE debtholders, but Treasury also limited the size of this contingent liability of the USG to \$100B. It would seem to be a difficult to justify treating GSE debt exactly the same as government debt from a regulatory capital perspective on this basis.

Those are the bold things Treasury and the Fed can do. The FRBNY may also attempt to stabilize or support the LEH situation by lending to LEH through the PDCF as a backstop until LEH works out its situation or to LEH's newco/spinco (with no other BSC-type intervention) - or they could facilitate a transaction by using the Maiden Lane structure that was set up for JPM/BSC in some way. Some or all of this may well prove necessary, but I personally doubt that it will make the market feel better. Perhaps I am wrong.

The Fed could also make another innovation in its liquidity facilities - perhaps a major extension in the term, say to three years (something like what the BOE has done). It is not clear why the Fed should do this when Treasury has created its own credit facility for the FHLBs. But there may be other assets that might benefit from longer term stable financing from the Fed.

Certainly the market does not expect many of these steps, and some of them would be a shot of cold water in the face. Some combination of the above might stabilize the situation for a time. We should be aware that any of the above are possible since all of them are entirely achievable by either Treasury or the Fed without any need to consult with or seek authority from Congress.

However, none of the above will fix the fundamental problem, which is too many bad assets that need to get off of too many balance sheets. This has always been the fundamental problem. Erin's report that all of the banks at Lehman's Financial Conference today laid out their plans for asset sales (HELOCs, construction loans, development books) as their main strategy for rehabilitating their balance sheets has very sobering implications for asset prices and the viability of this strategy, as she has pointed out. Her takeaway of the fierce competition from the largest banks for deposits also must be worrisome to policymakers. To me this says that it is time for the government to start seriously considering an RTC2.

By RTC2 I mean some sort of vehicle, either pre-funded by the government or backstopped with government money, that would purchase assets for once & for all off bank balance sheets, giving in their place a government recap bond of some sort. This should have a fairly aggressive conversion feature that would allow the government to dilute existing shareholders if the par amount are not repaid within some time period.

TAB 42

From: Jamie.McAndrews@ny.frb.org
To: [Patrick Parkinson](#); [Jeff Stehm](#)
Subject: Fw: Default Management Group 9 Sep 2008.doc
Date: 09/11/2008 02:06 PM
Attachments: [Default Management Group Sep 2008.doc](#)

For the meeting you are listening in on.

Jamie

Sent from my BlackBerry Wireless Handheld (www.BlackBerry.net)

----- Original Message -----
From: Jamie McAndrews
Sent: 09/11/2008 02:01 PM EDT
To: Tobias Adrian
Cc: Beverly Hirtle; Michael Schussler
Subject: Re: Default Management Group 9 Sep 2008.doc
Some edits:

(See attached file: Default Management Group Sep 2008.doc)

Tobias
Adrian/NY/FRS

To
09/11/2008 01:40
PM

Jamie McAndrews/NY/FRS@FRS

cc

Subject
Default Management Group 9 Sep
2008.doc

[attachment "Default Management Group 9 Sep 2008.doc" deleted by Jamie McAndrews/NY/FRS]



[- Default Management Group Sep 2008.doc](#)

Lehman Default Management Group

Purpose:

Convene a representative group of Lehman counterparties and creditors to make plans in the event of a bankruptcy filing by Lehman.

Under the auspices of the FRBNY, the group would initially consist of trading partners who trade contracts that are resolved outside the bankruptcy process, such as derivatives, swaps, QFCs, repos, commodities futures, etc. One set of firms that meet this definition would be all member firms of the CRMPG. The key is that firms conduct a “critical mass” of trades with Lehman, so that the close out of other trades would not confer large external costs on the market.

The purpose of the group is to reach a public agreement by the members of the group to hold off on fully exercising their contractual rights to close out their trades with the defaulting counterparty. Specific potential agreements could include an agreement to establish a process to net down all exposures versus the defaulting counterparty and an agreement to use a common valuation for marking positions after the bankruptcy filing.

Idea: There are three possibilities for the weekend: 1) single institution taking over, 2) consortium taking over, 3) bankruptcy.

Unless we have credible bankruptcy plan our negotiating position for limiting the subsidy in the liquidation consortium option will be weak. Consequently, planning for a bankruptcy will reduce some of the expected costs of bankruptcy and externalities imposed on the financial system as a whole, and make it a more viable alternative.

Timing: Contingent on the anticipated bankruptcy filing by Lehman, on Friday evening, after the markets have closed, issue invitations to the chief risk officers of the member firms. The meeting would convene at 9:00 a.m. on Saturday at the FRBNY, and continue through to Sunday evening.

Membership: Because the focus is primarily on the trading partners of Lehman, the membership will be broadly representative of the major financial counterparties of Lehman, including derivatives, futures, swaps, commodities, and repo counterparties. In addition, major regulators, both domestic and foreign, will be informed of the activity of the group.

A second, larger, group could be convened on the day of the bankruptcy, which would consist of all major creditors of the defaulting party.

Outcome: A public statement of the framework to which the members would have agreed. To be issued on Sunday evening.

Antitrust concerns: There is a concern that the group could engage in illegal price setting or other restraints of trade. To prevent this, the group should be open and it should rely on legal advice to avoid such agreements.

Activities of the group: During the weekend, the group would review their options for agreement on netting offsetting agreements, reaching common valuations for contracts post-bankruptcy, and achieving a framework for addressing all the issues that will arise after the bankruptcy filing. The Fed's role would be to be a neutral party that could assist the group in communicating to the public, and provide "cover" for the membership of the group (many excluded parties will feel that they are unfairly excluded).

Pros and Cons:

- Antitrust concerns; could include an attorney from the DOJ antitrust division
- Improved the Fed bargaining position for a resolution outside of bankruptcy
- Improved outcomes if bankruptcy were to occur.

TAB 43

[REDACTED]

From: Nason, David
Sent: Thursday, September 11, 2008 2:30 PM
To: 'bryan.corbett@do.treas.gov'; [REDACTED]
Subject: Re:

I am recused.

From: Bryan Corbett
To: Nason, David
Sent: Thu Sep 11 13:46:35 2008
Subject: RE:
Good for you.....get ready for the Lehman bailout

From: David.Nason@do.treas.gov [mailto:David.Nason@do.treas.gov]
Sent: Thursday, September 11, 2008 1:46 PM
To: Bryan Corbett
Subject:

Slogging through mtgs in nyc.

I was at gs from 10-7 yesterday.

< CONFIDENTIALITY NOTICE >

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TAB 44

From: [Coryann Stefansson](#)
To: [Deborah P Bailey](#)
Subject: Fw: LFI Counterparty Credit Risk Exposure to LEH
Date: 09/12/2008 04:05 PM

Coryann S. Stefansson
Associate Director
Bank Supervision and Regulation
Board of Governors
Office
Cell Number

Assistant - Ms. Kimberly Jensik
Kim.Jensik@frb.gov
Office Number

----- Forwarded by Coryann Stefansson/BOARD/FRS on 09/12/2008 04:05 PM -----

Dianne Dobbeck/NY/FRS@FRS

09/11/2008 04:15 PM

To BSR LFIC, Jeanmarie Davis/NY/FRS@FRS, John Ricketti/NY/FRS@FRS, Steven J Manzari/NY/FRS@FRS, Caroline Frawley/NY/FRS@FRS, Deborah P Bailey/BOARD/FRS@BOARD, Clinton Lively/NY/FRS@FRS
cc Brandon Hall/NY/FRS@FRS, Kyle Grieser/NY/FRS@FRS, Steven Mirsky/NY/FRS@FRS
Subject LFI Counterparty Credit Risk Exposure to LEH

Please find the first of two distributions outlining the LFIs exposure to LEH. The matrix of below (prepared by Brandon Hall of the counterparty credit risk) outlines select LFIs counterparty credit risk exposure to LEH. As expected, risk coordinators have regular conversations with the LFIs regarding their exposures to financial firms so the data were obtained through normal channels with in many cases the LFIs raising the topic to the relevant CPC team. We've elected to keep this distribution small (that is not include all of the CPC teams) in an effort not to promote new inquiries / specifical requests of the teams to the firms. In a follow-up message, Brandon will share a table that captures additional exposures the LFIs may have to LEH (e.g. committed lines, settlement lines, etc.) We welcome any questions you may have regarding the data collected.

An updated snapshot of LFI CCR exposures (on potential and current exposure bases) to Lehman Brothers, as well as institutional commentary, is provided below.

Exposure Update

Barclays, Citigroup, and UBS have demonstrated an upward trend in potential exposure to Lehman since 2Q08. Meanwhile, risk appetite has trended downward at Credit Suisse, JPMC, BAC, and Deutsche.

LFI Counterparty Exposures to Lehman Brothers (USD Millions)

Institution	As of Date	Current Exposure	Potential Exposure	Potential Exposure (2Q08)	Potential Exposure Trend (from 2Q08)	Potential Exposure Type
Citigroup	9/10/2008	\$207	\$2,600	\$2,435	UP	PSLE
JPMC	9/9/2008	\$898	\$2,381	\$3,289	DOWN	CCR Exposure: Incl. Sec Financing, Repos, etc.
Barclays	9/8/2008	\$0	\$2,080	\$1,689	UP	Total Trading PFE
CS	9/11/2008	\$219	\$1,385	\$1,595	DOWN	Derivatives Loan Equivalent (DLE)
UBS	9/9/2008	\$1,000	\$1,200	\$856	UP	15-day close-out period, 99% confidence interval
BAC	9/8/2008	\$139	\$883	\$960	DOWN	Potential Exposure (PE)
SocGen	9/9/2008	\$662	\$776	n/a	-	Peak CVAR over life of trade
Deutsche	8/21/2008	\$0	\$0	\$441	DOWN	Counterparty Utilization (gross of collateral)

Institutional Commentary

Barclays (As of 9/11/08)

Barclays has been following a business-as-usual strategy with Lehman, albeit with a more cautious approach to future business. All assignments and large/structured trades must be approved on an individual basis by Credit.

Overall, Barclays exposure to Lehman has increased to \$2.3B (from \$2.2B on July 11, 2007) despite the total financing limit (TFL) decreasing ~\$80MM to \$3.1B. The decrease in TFL is driven exclusively by a decrease in primary (lending) exposure from a decrease in Bond Holding (from \$172 million to \$141 million). There are currently no reported collateral disputes outstanding with Lehman. Total TFL is a numerical limit of the bank's credit risk appetite to a particular entity.

Citigroup (As of 9/10/08)

Previously, Citi had requested that Lehman leave \$2B on deposit to self-fund some of its intra-day clearing lines. On Monday, Citi and Lehman signed a formal agreement which gives Citi the right to offset any overdraft exposure against this deposit. Citi has informed Lehman that it will not extend any intra-day exposure beyond the size of this deposit. At the end of yesterday, Lehman added to the deposit, increasing it to \$2.7B. Yesterday, Citi approved (at the highest levels) an additional \$500MM above the \$2.7B in order to release a payment to CLS. The approval was based on Citi's confidence in CLS and the concern that holding this payment could be disruptive to an orderly settlement.

Citi continues to trade normally with Lehman. Citi has seen a pick-up in novation activity but continues to accept these. There were no notable collateral disputes with Lehman.

Total Exposure to Lehman is \$3.4B consisting of:

- \$2.6B potential exposure (\$207MM current exposure) from trading across 10 ISDA agreements
- \$610MM in direct loans (offset by \$490MM in CDS)
- \$50MM in un-drawn contingent lines

Citi also has \$3.2B in FX settlement limits for Lehman.

Credit Suisse (As of 9/11/08)

The firm has concerns about Lehman given the dramatic increase in CDS spreads and the declining share price. CS noted combined derivatives and FX MTM exposure of approximately \$130MM. This includes approximately \$70MM due to collateral not yet received and \$5MM in disputes.

The firm reported seeing a significant influx of requests for parties looking to novate away from Lehman. Novation requests have been seen across all desks, with particular concentration in FX trades. A few requests have been declined over the last two days when deemed outside the normal course of business. The firm is currently undertaking discussions to determine policy for what novations to accept and not.

CRM has increased monitoring on hedge funds R3 and GLG. Lehman Brothers has invested in R3's new debt strategies fund, which purchased \$5B in assets from Lehman in June.

Deutsche Bank (As of 8/21/08)

As of August 21st, DB does not have any credit exposure to Lehman Brothers. In fact, DB owes Lehman around \$2.1B on derivative trades, of which DB has posted to Lehman \$2.0B in cash and Treasuries.

As of last week's meeting with CRM, DB has not changed its stance in that it will continue to watch Lehman very carefully, but is not prepared to curtail trading with Lehman at this time.

JPMC (As of 9/10/08)

JPMC has secured an additional \$3B in O/N collateral since yesterday from Lehman, and that is posted under a lien agreement in place with the firm. The collateral consisted of \$1B in cash posted yesterday and \$2B in JPMC money market fund investments made by Lehman. Today Lehman asked to substitute in some securities and JPMC risk executives are considering it. JPMC was concerned about not being in a position to meet calls on behalf of Lehman and so requested the additional coverage. Lehman met that request in addition to covering roughly \$500MM in collateral disputes outstanding. To the extent JPMC determines the disputes are not warranted they may return collateral to Lehman but for now Lehman agreed to cover them.

3rd party haircuts are up substantially although no more details were offered other than confirmation one large investor has doubled their haircuts (from 8% to 16/20%). If tri-party investors increase haircuts it will force Lehman to reduce the size of its book.

A one notch ratings agency downgrade would require Lehman to post an additional \$2B in collateral (Lehman's estimate) and a two notch downgrade approximately \$5B in collateral across all counterparties. They are concerned that the rating agencies, particularly S&P, are ready to act and may not be satisfied by the proposed asset sales and real estate spin.

Novation activity has picked up on Lehman throughout the day but it is still too early to determine if the underlying exposures are sizable. JPMC is very sensitive to other firms attempting to move entire derivative books over without telling JPMC upfront and so may reserve the right to decline the novation requests if they feel that is the case.

JPMC reiterated, as it has in the past, that it does not want to be the first to stop trading, cut lines, and/or run from Lehman and are mindful of the implications of such a decision. However, they did state that they do not want to be the last one to make that decision and so will remain vigilant concerning (a) prime brokerage onboarding activity at JPMC, (b) activities of other major counterparties, and (c) behavior of tri-party investors.

UBS (As of 9/9/08)

As of 9/9/08, UBS's posture toward Lehman is business as usual. Traders were instructed to continue dealing with Lehman over the next 24 hours. Lines will not be cut and the name will not be turned down. Traders were instructed to hedge (correlated) exposure where possible. UBS is most concerned with the sensitivity in the derivatives book and correlation risk (assets held such as CRE/CMBS that may deteriorate if Lehman deteriorates further).

UBS is monitoring the Lehman PB business and noted that one hedge fund is planning on moving away from Lehman to UBS. UBS will continue to monitor the PB business and will let us know if other HF's begin to move away from Lehman. UBS is also reviewing legal contracts, determining which Lehman entities they are exposed to and running various stress scenarios on current exposures.

UBS's exposure to Lehman is as follows:

1. OTC derivatives: \$1B MTM / Net of Collateral: \$15MM MTM
2. Uncollateralized OTC derivatives: ~\$0
3. Close-out exposure: \$1.2B
4. Securities Borrowing/Lending
 - UBS has lent out \$4.7B in securities to Lehman entities (105% collateralized)
 - UBS has borrowed \$900MM in securities from Lehman entities (collateralized)
 - Repo: UBS has cash in of around \$400MM and cash out of around \$300MM.

From: [Coryann Stefansson](#)
To: [Deborah P Bailey](#)
Subject: Fw: LFI Key Credit Risk Exposures to LEH - COB Update
Date: 09/11/2008 06:36 PM

Coryann S. Stefansson
Associate Director
Bank Supervision and Regulation
Board of Governors
Office
Cell Number

Assistant - Ms. Kimberly Jensik
Kim.Jensik@frb.gov
Office Number

----- Forwarded by Coryann Stefansson/BOARD/FRS on 09/11/2008 06:34 PM -----

Brandon Hall/NY/FRS@FRS

09/11/2008 06:18 PM

To: Dianne Dobbeck/NY/FRS@FRS, BSR LFIC, Caroline Frawley/NY/FRS@FRS, Clinton Lively/NY/FRS@FRS, Deborah P Bailey/BOARD/FRS@BOARD, Jeanmarie Davis/NY/FRS@FRS, John Ricketti/NY/FRS@FRS, Steven J Manzari/NY/FRS@FRS
cc: Steven Mirsky/NY/FRS@FRS, Kyle Grieser/NY/FRS@FRS, William Hallacy/NY/FRS@FRS
Subject: Fw: LFI Key Credit Risk Exposures to LEH - COB Update

As per Dianne's message below, the table following here captures LFI key credit risk exposures to LEH including Lending and Settlement alongside Trading. Data is sorted by Trading Potential Exposure.

Please note that in the body of the forwarded message below, updated commentary has been added to the Barclays note. In addition, the "LFI Counterparty Exposures to LEH" table has undergone slight revisions - including the addition of BNPP data - and should be treated as the most current version available.

LFI Credit Exposures to Lehman Brothers (USD or EUR Millions)

INSTITUTION	AS OF DATE	LENDING	TRADING		SETTLEMENT LIMITS
			Current Exp.	Potential Exp.	
Citigroup	09/10/08	\$120	\$207	\$2,600	\$3,200
JPMC	09/05/08	\$686	\$898	\$2,381	\$10,681
Barclays	09/08/08	\$211	\$30	\$2,080	\$4,284
CS	09/11/08	\$68	\$219	\$1,385	n/a
BNPP	09/09/08	€ 408	€ 531	€ 691	n/a
UBS	09/09/08	n/a	\$1,100	\$1,200	n/a
BAC	09/08/08	\$125	\$139	\$887	\$4,012
SocGen	09/09/08	\$0	\$662	\$776	n/a
Deutsche	09/10/08	\$0	\$0	\$0	n/a

Brandon J. Hall
Counterparty Credit Risk Monitoring & Analysis
Federal Reserve Bank of New York
33 Liberty St. | New York, NY 10045

----- Forwarded by Brandon Hall/NY/FRS on 09/11/2008 05:59 PM -----

Dianne Dobbeck/NY/FRS

09/11/2008 04:18 PM

To: BSR LFIC, Jeanmarie Davis/NY/FRS@FRS, John Ricketti/NY/FRS@FRS, Steven J Manzari/NY/FRS@FRS, Caroline Frawley/NY/FRS@FRS, Deborah P Bailey/BOARD/FRS@BOARD, Clinton Lively/NY/FRS@FRS
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BNPP	09/09/08	€ 531	€ 691	n/a	-	Potential Future Exposure
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Barclays (As of 9/11/08)

Barclays has been following a business-as-usual strategy with Lehman, albeit with a more cautious approach to future business. Barclays has not stopped doing business with LEH but the firm continues to actively monitor its exposure to LEH on an intra-day basis. All assignments and large/structured trades must be approved on an individual basis by Credit.

The firm's main concern right now is intra-day settlement risk generated from "give ups" ("give ups" refer to arrangements common in FX business whereby a counterparty transfers its trade with Barclays to another firm, and Barclays must settle with the other firm. In this situation, Barclays does not know of this settlement risk with an alternative counterparty until COB. "Give ups" are slightly different than novations, which are formerly papered and assigned.). Today, Barclays considered requesting that clients notify the firm real time of any "give ups", so that Barclays can better monitor its intra-day exposure to counterparties such as Lehman. However, the firm ultimately decided against this change in strategy given the potential adverse reputational impact.

Overall, Barclays exposure to Lehman has increased to \$2.3B (from \$2.2B on July 11, 2007) despite the total financing limit (TFL) decreasing ~\$80MM to \$3.1B. The decrease in TFL is driven exclusively by a decrease in primary (lending) exposure from a decrease in Bond Holding (from \$172 million to \$141 million). There are currently no reported collateral disputes outstanding with Lehman. Total TFL is a numerical limit of the bank's credit risk appetite to a particular entity.

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- Repo: UBS has cash in of around \$400MM and cash out of around \$300MM.

TAB 45

[REDACTED]

From: Rutherford, Matthew
Sent: Friday, September 12, 2008 8:01 AM
To: Wilkinson, Jim
Subject: Market Sentiment

See the email below. I would be careful about any statement. Markets are incredibly nervous.

-----Original Message-----

From: Hayley.Boesky@ny.frb.org [mailto:Hayley.Boesky@ny.frb.org]
Sent: Thursday, September 11, 2008 11:58 PM
To: Hayley.Boesky@ny.frb.org
Cc: Brian.Peters@ny.frb.org; Debby.Perelmutter@ny.frb.org; James.Clark@ny.frb.org; Matthew.Lieber@ny.frb.org; Rutherford, Matthew; Meg.McConnell@ny.frb.org; Michael.Nelson@ny.frb.org; Schetzel, Michael; Patricia.Mosser@ny.frb.org; Steven.Friedman@ny.frb.org; William.Dudley@ny.frb.org
Subject: Panic

I have spent the past 3 hours receiving calls from HFs. On a scale of 1 to 10, where 10 is Bear-Stearns-week-panic, I would put sentiment today at a 12.

People are expecting full blown recession. There is full expectation that Leh goes, wamu and then ML. Worries about GS and reports of losses in their PB business. Apparently GS had a lot of commodity HFs who took big losses. ALL begging, pleading for a large scale solution which spans beyond just LEH. The two ideas which keep coming up are easing risk capital weights and a RTC type fund. Objective is to ease balance sheet pressures of the banks.

I am sure you have all heard lots of this but I felt I needed to relay the message given they all took the time to call and given the panic in their voices...

----- Original Message -----

From: Hayley Boesky
Sent: 09/11/2008 11:36 AM EDT
To: Hayley Boesky
Cc: Brian Peters; Debby Perelmutter; James Clark; Matthew Lieber; Matthew.Rutherford@do.treas.gov; Meg McConnell; Michael Nelson; Michael Schetzel; Patricia Mosser; Steven Friedman; William Dudley
Subject: Re: Fw: Options for short-circuiting the market nearly every large HF (Moore Cap, Tudor, Fortress, etc.) has called to tell me that others are refusing to take LEH's name

Hayley R. Boesky
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Telephone: [REDACTED]
Mobile: [REDACTED]

Hayley
Boesky/NY/FRS

To

09/11/2008 10:46
AM

Meg McConnell/NY/FRS, Bill Dudley,
Patricia Mosser/NY/FRS, Brian
Peters/NY/FRS, Michael
Nelson/NY/FRS, Debby Perelmuter,
Michael Schetzel/NY/FRS,
Matthew.Rutherford@do.treas.gov
cc
steven.friedman@ny.frb.org, James G
Clark/NY/FRS@FRS, Matthew
Lieber/NY/FRS@FRS
Subject
FW: Options for short-circuiting
the market

some thots from Louis. I have bolded the relevant points.

Hayley R. Boesky
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Telephone: [REDACTED]

Mobile: [REDACTED]

----- Forwarded by Hayley Boesky/NY/FRS on 09/11/2008 10:08 AM -----

"Louis Bacon"
[REDACTED]

09/11/2008 09:10
AM

<Hayley.Boesky@ny.frb.org>

To

cc

Subject
FW: Options for short-circuiting the
market

Our thoughts as of earlier.

On a day like this it make sense to make a quick list of what the Fed and/or Treasury can do tomorrow/at any point to try to short circuit what is going on in the markets. To be clear - I do not have any specific intelligence on how any of these are being considered by policymakers. This is only to lay out what is legally possible. All of the items on this first list are entirely achievable by either Treasury or the Fed without any need to consult with or seek authority from Congress

The Fed can cut rates - either on the 16th or intermeeting. They have at least 150bps of ease without getting us into Japan territory. FOMC as a group could not accept the tradeoff on inflation for a FF rate lower than 2.00%. The last cut was April 30th. Crude was at \$113. In the interim, the markets and the economy got worse (worse than the Fed had expected), and crude went to \$145. Crude is at \$103. Going forward, inflation is only going to go one way - South. The Fed should seriously consider cutting.

The Treasury can announce a large GSE MBS purchase program under their GSE support package from this weekend. They were hoping for a big positive bounce from the GSE package and announcement and I suspect they were waiting to see if they could get away with something small. If it made sense to cross the threshold to have the US purchase GSE MBS in the first place, then the Treasury should announce a big number that will make the market think again (positively) about the value of any GSE MBS banks hold. All the critiques of this weekend's GSE plan will still apply (it doesn't fix the problems with the bad assets/private-label MBS, HELOCS, underwater borrowers, unemployment), but this is a step that Treasury has all the authority it needs to take immediately and which they should take in conjunction with a Fed move.

The Treasury can announce a major expansion of funding to the Federal Home Loan Bank system. This would be passed on to banks via a major expansion of advances from the Federal Home Loan Banks against mortgage-related collateral, including term advances of up to three years. This would be out of left field, but Treasury already has all the legal authority and all the budget authority it would need to do this. (Treasury somewhat-unexpectedly asked for the authority to support the FHLBs, along with the authorities they used in this weekend's GSE package, in the July legislation.) Treasury may be positioning for something of the sort - this weekend, when they announced the new Treasury credit facility for the GSEs (Government Sponsored Enterprise Credit Facility), they opened the credit facility to the FHLBs as well as to Fannie & Freddie. The FHLBs can borrow from this new Treasury credit facility at Libor+50 by pledging advances that the FHLBs make to banks. This is intended to be short term credit facility, with loan terms from one week to one month, renewable. But if Treasury wanted to crank up a major Treasury lending program for the FHLBs and make the loans long-term, it could allow the FHLBs to provide even more significant term funding at predictable rates to banks for their mortgage-related assets including HELOCS, whole loans, etc.

Bank regulators can cut risk weightings on GSE-issued MBS and debt on the basis that the government has backstopped the Agencies. This would free up balance sheet and help with the capital problems at banks. The one stumbling block to this is that the Treasury included an explicit "Disclaimer of Guarantee" in their \$100B backstop agreement with the GSEs this weekend. This states clearly that Treasury's commitment "shall not be deemed to constitute a guarantee" by the United States of the payment or performance of any debt security of the GSEs. So, Treasury converted the implicit guarantee into an explicit contingent liability of the USG for the express benefit of the GSE debtholders, but Treasury also limited the size of this contingent liability of the USG to \$100B. It would seem to be a difficult to justify treating GSE debt exactly the same as government debt from a regulatory capital perspective on this basis.

Those are the bold things Treasury and the Fed can do. The FRBNY may also attempt to stabilize or support the LEH situation by lending to LEH through the PDCF as a backstop until LEH works out its situation or to LEH's newco/spinco (with no other BSC-type intervention) - or they could facilitate a transaction by using the Maiden Lane structure that was set up for JPM/BSC in some way. Some or all of this may well prove necessary, but I personally doubt that it will make the market feel better. Perhaps I am wrong.

The Fed could also make another innovation in its liquidity facilities - perhaps a major extension in the term, say to three years (something like what the BOE has done). It is not clear why the Fed should do this when Treasury has created its own credit facility for the FHLBs. But there may be other assets that might benefit from longer term stable financing from the Fed.

Certainly the market does not expect many of these steps, and some of them would be a shot of cold water in the face. Some combination of the above might stabilize the situation for a time. We should be aware that any of the above are possible since all of them are entirely achievable by either Treasury or the Fed without any need to consult with or seek authority from Congress.

However, none of the above will fix the fundamental problem, which is too many bad assets that need to get off of too many balance sheets. This has always been the fundamental problem. Erin's report that all of the banks at Lehman's Financial Conference today laid out their plans for asset sales (HELOCs, construction loans, development books) as their main strategy for rehabilitating their balance sheets has very sobering implications for asset prices and the viability of this strategy, as she has pointed out. Her takeaway of the fierce competition from the largest banks for deposits also must be worrisome to policymakers. To me this says that it is time for the government to start seriously considering an RTC2.

By RTC2 I mean some sort of vehicle, either pre-funded by the government or backstopped with government money, that would purchase assets for once & for all off bank balance sheets, giving in their place a government recap bond of some sort. This should have a fairly aggressive conversion feature that would allow the government to dilute existing shareholders if the par amount are not repaid within some time period.

TAB 46

From: [Ada Li](#)
To: [Jeff Stehm](#); [Patrick M Parkinson](#); [Pat White](#); [Jeffrey Marquardt](#)
Cc: [Theodore Lubke](#); [Wendy Ng](#)
Subject: Fw: Bankruptcy doc
Date: 09/12/2008 09:15 AM
Attachments: [Decision to file Bankruptcy 4.doc](#)

FYI --also for the 9 AM meeting.

Thanks,
Ada Li
Federal Reserve Bank
Tel: 212-720-6468
Ada.Li@ny.frb.org

----- Forwarded by Ada Li/NY/FRS on 09/12/2008 09:15 AM -----

Lily Tham/NY/FRS

09/12/2008 01:28 AM

To	Theodore Lubke/NY/FRS@FRS
cc	Michael Schussler/NY/FRS@FRS, Steven Pesek/NY/FRS@FRS, Wendy Ng/NY/FRS, Ada Li/NY/FRS, Shari Ben-Haim/NY/FRS@FRS, mcgowant@sec.gov
Subject	Bankruptcy doc

Hi, Theo,
Attached is the latest version **Decision to File Bankruptcy** document prepared by Tom McGovan and Michael Schussler. I'll leave it to you to pass on to the broader mailing list, as appropriate.

I'll be in the office around 8:30am tomorrow. Thanks!



Decision to file Bankruptcy 4.doc

Decision to file Bankruptcy

Lehman Brothers Holding Inc. (“Lehman”) would need to resolve a number of complex issues before electing to file for bankruptcy protection. The issues include (1) which entities are eligible for bankruptcy protection; (2) which entities are subject to customer claims that would be effectively stayed by a bankruptcy filing; (3) would regulatory interests be inconsistent with management’s reasons for seeking bankruptcy protection; (4) when should a filing take place.

The decision by the board to seek bankruptcy protection for the holding company does not necessarily imply that each subsidiary also will be subject to the bankruptcy proceeding. We would expect that many of Lehman’s material affiliates would not seek bankruptcy protection. The applicable authority for initiating insolvency proceedings for these affiliates is described below.

Timing of Bankruptcy Filing

One option would be to urge Lehman to file mid-afternoon (such as Sunday before 6:00 p.m.) to provide markets, clearing entities, and counterparties time to react to the filing. However, it may be less disruptive to the tri-party repo market if a filing delayed until after the morning unwind. In contrast, Lehman may have an interest to file at a different time even though filing at that time may be more disruptive to the markets. Our expectation is that the firm would work with regulators to file for bankruptcy at such a time that would minimize disruption to the markets.

U.S. Depository Institutions

With respect Lehman’s thrift and ILC, only the chartering authorities or the FDIC have authority to place the entities into receivership or into other insolvency proceedings. Neither the thrift nor the ILC can be subject of a voluntary or involuntary insolvency proceeding. Regulators can monitor the liquidation of the holding company and other entities that are in bankruptcy as well as the operations of the thrift and ILC to determine what steps may be appropriate if those firms face financial or operational difficulties.

ILC	-	Lehman Brothers Commercial Bank
Thrift	-	Lehman Brothers Bank, FSB

U.S. Registered Broker-Dealers and Investment Advisors

If Lehman filed for bankruptcy, assuming the broker-dealer remains in compliance with applicable regulatory requirements, the SEC would work towards ensuring that the broker-dealer self-liquidate and not be part of a formal insolvency proceeding. With respect to the U.S. registered brokers, a broker-dealer with “customers” would not be eligible for Chapter 11 (Reorganization). Accordingly, Lehman Brothers, Inc. and Neuberger Berman LLC. would not be eligible to be included in a Chapter 11 reorganization. Further, as a policy matter, the SEC would require that Lehman Brothers Inc. be liquidated under SIPA, if a formal liquidation was appropriate. Unless the broker-dealer was not in compliance with the financial responsibility rules, the preference would be that Lehman Brothers Inc. self-liquidate under the supervision of

the SEC, the CFTC, and self-regulatory organizations. We note that Lehman Brothers, Inc. has two significant subsidiaries, a derivatives affiliate and a commercial paper dealer. Those entities would likely be liquidated separately from the broker-dealer.

Neuberger Berman also owns a registered investment advisor that would be eligible for Chapter 11 bankruptcy; however, a Chapter 11 filing would likely cause assignment of advisory contract and change of control regulatory issues for the advisor.

Lehman Brothers OTC Derivatives Dealer, Inc., a registered limited purpose broker-dealer, may be a “stockbroker” under the bankruptcy code and would therefore not be eligible to be reorganized under Chapter 11. The OTC derivatives dealer is not a member of SIPC and would not be liquidated under SIPA.

Other Derivative Dealers and Material Unregistered Affiliates

There is a great deal of uncertainty regarding how unregistered Lehman affiliates would be liquidated. Lehman owns a number of unregistered derivatives dealers, such as Lehman Special Financing, Inc., and other material entities such as Lehman Commercial Paper, Inc. These entities are eligible for Chapter 11 and Chapter 7 bankruptcy. However, the holding company may elect not to seek bankruptcy protection for these firms, especially if these firms remain sufficiently capitalized and liquid. The derivatives dealers also may also meet the definition of a “stockbroker” under the bankruptcy code and therefore only be eligible for liquidation under Chapter 7. Unregistered affiliates include ALI, Lehman Brothers Commercial Corporation, Lehman Brothers Derivatives Products, Lehman Brothers OTC Derivatives, and LBI Group.

Foreign Subsidiaries

Lehman owns a number of foreign entities, some of which are registered as banks or securities firms in their respective foreign jurisdictions. These entities would be subject to foreign bankruptcy regimes. At the discretion of the appropriate local authorities, their proceedings could be handled separately or as part of a U.S. bankruptcy proceeding. Key foreign entities are Lehman Brothers Bankhaus, AG (German bank - BaFin), Lehman Brothers International Europe (U.K. broker-dealer – U.K. FSA), Lehman Brothers Europe LTD. (U.K. FSA), Lehman Brothers Finance SA (unregistered), Lehman Brothers Japan (broker-dealer, Japan FSA), Lehman Brothers Luxembourg SA (unregistered), and Lehman Brothers Treasury Co. BV (unregistered).

Actions by U.S. Regulators upon Lehman Bankruptcy Filing

Supervisors would need to review whether to take any action in response to a bankruptcy filing by Lehman. Further, supervisors would monitor the formal and informal self-liquidations of Lehman and its affiliates to determine whether regulatory action should be taken. Particular events which may require supervisors to reconsider their decisions would include actions taken by clearing houses and clearing banks, decisions by foreign regulators, a determination that a bank or broker-dealer is no longer in compliance with applicable regulatory requirements.

Securities Investor Protection Act of 1970 (“SIPA”)

Generally, all U.S. registered broker-dealers are members of the Securities Investor Protection Corporation (“SIPC”). SIPC may seek to begin a SIPA proceeding if any member of SIPC has failed or is in danger of failing to meet its obligations to customers, and the broker-dealer

- (i) is insolvent;
- (ii) subject to a proceeding pending in any court or before any agency of the United States of any State in which a receiver, trustee, or liquidator has been appointed;
- (iii) is not in compliance with applicable SEC or self-regulatory organization financial responsibility rules or hypothecation of customers’ securities; or
- (iv) is unable to make such computation as may be necessary to establish compliance with those financial responsibility or hypothecation rules.

The broker-dealer has the ability to consent or object to the application to place the firm in a SIPA proceeding. If the broker-dealer objects, the application shall be heard three business days after the date the application is filed, or at such other time as the court may determine taking into consideration the urgency which the circumstances require. If the broker-dealer does not consent to the SIPA liquidation, SIPC will look to SEC or FINRA examiners to demonstrate that the firm is not in compliance, or is unable to demonstrate compliance, with the applicable financial responsibility rules. In the event of a SIPA proceeding for a large broker-dealer, the court would appoint a person specified by SIPC to serve as the trustee to administer the liquidation.

Generally, a “customer” is defined in SIPA as a person who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker-dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral security, or for purposes of effecting transfer. SIPC has taken the position that counterparties to repurchase transactions and securities lending are not customers under SIPA.

A SIPA liquidation would likely proceed in a similar manner as a self-liquidation. The trustee would look to complete a bulk transfer of securities accounts to a solvent broker-dealer as quickly as possible. However, even after the trustee has completed returning all customer property, a SIPC liquidation may continue as the trustee seeks to collect amounts owed to the broker-dealer or SIPC

TAB 47

[REDACTED]

From: Abby Adlerman-San Francisco [REDACTED]
Sent: Friday, September 12, 2008 11:09 AM
To: Wilkinson, JimDisabled
Subject: Re: Paulson Statement on Treasury and FHFA Action to Protect Financial Markets and Taxpayers
Attachments: oie0.bmp

Thanks - really appreciate the effort. I hope he buys into the notion that two firms pulling are better than one. Easy way to separate is they do one and we do another. Spencer will push back saying its inefficient but sort of self-serving.
Talk soon,
Abby

From: Jim.Wilkinson@do.treas.gov
To: Abby Adlerman-San Francisco
Sent: Fri Sep 12 08:49:12 2008
Subject: RE: Paulson Statement on Treasury and FHFA Action to Protect Financial Markets and Taxpayers

Hey there...good morning...looks like Paulson will go to NYC tonight to sort through this Lehman mess...can't imagine a scenario where we put in govt money...we shall see...on the below, Lockhart already had an arrangement sent up with Spencer Stuart apparently to vet folks with a preexisting effort...I am going to see Lockhart for lunch today. I want to see if I can get you guys in there as well...more soon...

From: Abby Adlerman-San Francisco [REDACTED]
Sent: Thursday, September 11, 2008 10:14 PM
To: Wilkinson, Jim
Subject: RE: Paulson Statement on Treasury and FHFA Action to Protect Financial Markets and Taxpayers

Hey Jim
Good to catch up. Thanks for the call. FYI, it turns out that Ken Wilson is close with one of my partners, Gordie Grand, in NY. Gordie is a financial officers specialist and has done work for Freddie in the past. I think Ken would trust him imminently. Gordie would be one of the people available to join me on Tuesday if that works for you and Ken.

Talk soon,
Abby

From: Jim.Wilkinson@do.treas.gov [mailto:Jim.Wilkinson@do.treas.gov]

Sent: Wednesday, September 10, 2008 6:15 PM

To: Abby Adlerman-San Francisco

Subject: Re: Paulson Statement on Treasury and FHFA Action to Protect Financial Markets and Taxpayers

I'm actually leading the work on the new teams...can I call you tomorrow to talk?

From: Abby Adlerman-San Francisco

To: Wilkinson, Jim

Sent: Wed Sep 10 20:53:46 2008

Subject: RE: Paulson Statement on Treasury and FHFA Action to Protect Financial Markets and Taxpayers

Jim

Thanks for sending this. I have been watching for the last four or five days with awe. The impact on you, professionally, is something we should talk about on the phone.

What is Treasury doing about new management and Board? Ironically, I was on a conference call with Karen Horn last Friday on an entirely different subject I assure you! She had to pause the call a few times to take side calls -- I suspect that aspect was related. :-)

If it is appropriate for Russell Reynolds Associates to be talking with people there are leadership changes for Fannie and Freddie, we have an outstanding and knowledgeable team in Washington, NY and elsewhere.

Regards

Abby

From: Jim.Wilkinson@do.treas.gov [mailto:Jim.Wilkinson@do.treas.gov]

Sent: Sunday, September 07, 2008 8:49 AM

To: Abby Adlerman-San Francisco

Subject: Fw: Paulson Statement on Treasury and FHFA Action to Protect Financial Markets and Taxpayers

Fun couple of weeks here Abby!

From: Forsell, Courtney

To: Forsell, Courtney

Sent: Sun Sep 07 11:01:32 2008

Subject: Paulson Statement on Treasury and FHFA Action to Protect Financial Markets and Taxpayers

U.S. Treasury Department Office of Public Affairs

Embargoed Until, 11 a.m. (EDT), September 7, 2008
Contact Brookly McLaughlin, (202) 622-2920

Statement by Secretary Henry M. Paulson, Jr.

on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers

Washington, DC- Good morning. I'm joined here by Jim Lockhart, Director of the new independent regulator, the Federal Housing Finance Agency, FHFA.

In July, Congress granted the Treasury, the Federal Reserve and FHFA new authorities with respect to the GSEs, Fannie Mae and Freddie Mac. Since that time, we have closely monitored financial market and business conditions and have analyzed in great detail the current financial condition of the GSEs - including the ability of the GSEs to weather a variety of market conditions going forward. As a result of this work, we have determined that it is necessary to take action.

Since this difficult period for the GSEs began, I have clearly stated three critical objectives: providing stability to financial markets, supporting the availability of mortgage finance, and protecting taxpayers - both by minimizing the near term costs to the taxpayer and by setting policymakers on a course to resolve the systemic risk created by the inherent conflict in the GSE structure.

Based on what we have learned about these institutions over the last four weeks - including what we learned about their capital requirements - and given the condition of financial markets today, I concluded that it would not have been in the best interest of the taxpayers for Treasury to simply make an equity investment in these enterprises in their current form.

The four steps we are announcing today are the result of detailed and thorough collaboration between FHFA, the U.S. Treasury, and the Federal Reserve.

We examined all options available, and determined that this comprehensive and complementary set of actions best meets our three objectives of market stability, mortgage availability and taxpayer protection.

Throughout this process we have been in close communication with the GSEs themselves. I have also consulted with Members of Congress from both parties and I appreciate their support as FHFA, the Federal Reserve and the Treasury have moved to address this difficult issue.

Before I turn to Jim to discuss the action he is taking today, let me make clear that these two institutions are unique. They operate solely in the mortgage market and are therefore more exposed than other financial institutions to the housing correction. Their statutory capital requirements are thin and poorly defined as compared to other institutions. Nothing about our actions today in any way reflects a changed view of the housing correction or of the strength of other U.S. financial institutions.

I support the Director's decision as necessary and appropriate and had advised him that conservatorship was the only form in which I would commit taxpayer money to the GSEs.

I appreciate the productive cooperation we have received from the boards and the management of both GSEs. I attribute the need for today's action primarily to the inherent conflict and flawed business model embedded in the GSE structure, and to the ongoing housing correction. GSE managements and their Boards are responsible for neither. New CEOs supported by new non-executive Chairmen have taken over management of the enterprises, and we hope and expect that the vast majority of key professionals will remain in their jobs. I am particularly pleased that the departing CEOs, Dan Mudd and Dick Syron, have agreed to stay on for a period to help with the transition.

I have long said that the housing correction poses the biggest risk to our economy. It is a drag on our economic growth, and at the heart of the turmoil and stress for our financial markets and financial institutions. Our economy and our markets will not recover until the bulk of this housing correction is behind us. Fannie Mae and Freddie Mac are critical to turning the corner on housing. Therefore, the primary mission of these enterprises now will be to proactively work to increase the availability of mortgage finance, including by examining the guaranty fee structure with an eye toward mortgage affordability.

To promote stability in the secondary mortgage market and lower the cost of funding, the GSEs will modestly increase their MBS portfolios through the end of 2009. Then, to address systemic risk, in 2010 their portfolios will begin to be gradually reduced at the rate of 10 percent per year, largely through natural run off, eventually stabilizing at a lower, less risky size.

Treasury has taken three additional steps to complement FHFA's decision to place both enterprises in conservatorship. First, Treasury and FHFA have established Preferred Stock Purchase Agreements, contractual agreements between the Treasury and the conserved entities. Under these agreements, Treasury will ensure that each company maintains a positive net worth. These agreements support market stability by providing additional security and clarity to GSE debt holders - senior and subordinated - and support mortgage availability by providing additional confidence to investors in GSE mortgage backed securities. This commitment will eliminate any mandatory triggering of receivership and will ensure that the conserved entities have the ability to fulfill their financial obligations. It is more efficient than a one-time equity injection, because it will be used only as needed and on terms that Treasury has set. With this agreement, Treasury receives senior preferred equity shares and warrants that protect taxpayers. Additionally, under the terms of the agreement, common and preferred shareholders bear losses ahead of the new government senior preferred shares.

These Preferred Stock Purchase Agreements were made necessary by the ambiguities in the GSE Congressional charters, which have been perceived to indicate government support for agency debt and guaranteed MBS. Our nation has tolerated these ambiguities for too long, and as a result GSE debt and MBS are held by central banks and investors throughout the United States and around the world who believe them to be virtually risk-free. Because the U.S. Government created these ambiguities, we have a responsibility to both avert and ultimately address the systemic risk now posed by the scale and breadth of the holdings of GSE debt and MBS.

Market discipline is best served when shareholders bear both the risk and the reward of their investment. While conservatorship does not eliminate the common stock, it does place common shareholders last in terms of claims on the assets of the enterprise.

Similarly, conservatorship does not eliminate the outstanding preferred stock, but does place preferred shareholders second, after the common shareholders, in absorbing losses. The federal banking agencies are assessing the exposures of banks and thrifts to Fannie Mae and

Freddie Mac. The agencies believe that, while many institutions hold common or preferred shares of these two GSEs, only a limited number of smaller institutions have holdings that are significant compared to their capital.

The agencies encourage depository institutions to contact their primary federal regulator if they believe that losses on their holdings of Fannie Mae or Freddie Mac common or preferred shares, whether realized or unrealized, are likely to reduce their regulatory capital below "well capitalized." The banking agencies are prepared to work with the affected institutions to develop capital restoration plans consistent with the capital regulations.

Preferred stock investors should recognize that the GSEs are unlike any other financial institutions and consequently GSE preferred stocks are not a good proxy for financial institution preferred stock more broadly. By stabilizing the GSEs so they can better perform their mission, today's action should accelerate stabilization in the housing market, ultimately benefiting financial institutions. The broader market for preferred stock issuance should continue to remain available for well-capitalized institutions.

The second step Treasury is taking today is the establishment of a new secured lending credit facility which will be available to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Given the combination of actions we are taking, including the Preferred Share Purchase Agreements, we expect the GSEs to be in a stronger position to fund their regular business activities in the capital markets. This facility is intended to serve as an ultimate liquidity backstop, in essence, implementing the temporary liquidity backstop authority granted by Congress in July, and will be available until those authorities expire in December 2009.

Finally, to further support the availability of mortgage financing for millions of Americans, Treasury is initiating a temporary program to purchase GSE MBS. During this ongoing housing correction, the GSE portfolios have been constrained, both by their own capital situation and by regulatory efforts to address systemic risk. As the GSEs have grappled with their difficulties, we've seen mortgage rate spreads to Treasuries widen, making mortgages less affordable for homebuyers. While the GSEs are expected to moderately increase the size of their portfolios over the next 15 months through prudent mortgage purchases, complementary government efforts can aid mortgage affordability. Treasury will begin this new program later this month, investing in new GSE MBS. Additional purchases will be made as deemed appropriate. Given that Treasury can hold these securities to maturity, the spreads between Treasury issuances and GSE MBS indicate that there is no reason to expect taxpayer losses from this program, and, in fact, it could produce gains. This program will also expire with the Treasury's temporary authorities in December 2009.

Together, this four part program is the best means of protecting our markets and the taxpayers from the systemic risk posed by the current financial condition of the GSEs. Because the GSEs are in conservatorship, they will no longer be managed with a strategy to maximize common shareholder returns, a strategy which historically encouraged risk-taking. The Preferred Stock Purchase Agreements minimize current cash outlays, and give taxpayers a large stake in the future value of these entities. In the end, the ultimate cost to the taxpayer will depend on the business results of the GSEs going forward. To that end, the steps we have taken to support the GSE debt and to support the mortgage market will together improve the housing market, the US economy and the GSEs' business outlook.

Through the four actions we have taken today, FHFA and Treasury have acted on the responsibilities we have to protect the stability of the financial markets, including the mortgage market, and to protect the taxpayer to the maximum extent possible.

And let me make clear what today's actions mean for Americans and their families. Fannie Mae and Freddie Mac are so large and so interwoven in our financial system that a failure of either of them would cause great turmoil in our financial markets here at home and around the

globe. This turmoil would directly and negatively impact household wealth: from family budgets, to home values, to savings for college and retirement. A failure would affect the ability of Americans to get home loans, auto loans and other consumer credit and business finance. And a failure would be harmful to economic growth and job creation. That is why we have taken these actions today.

While we expect these four steps to provide greater stability and certainty to market participants and provide long-term clarity to investors in GSE debt and MBS securities, our collective work is not complete. At the end of next year, the Treasury temporary authorities will expire, the GSE portfolios will begin to gradually run off, and the GSEs will begin to pay the government a fee to compensate taxpayers for the on-going support provided by the Preferred Stock Purchase Agreements. Together, these factors should give momentum and urgency to the reform cause. Policymakers must view this next period as a "time out" where we have stabilized the GSEs while we decide their future role and structure.

Because the GSEs are Congressionally-chartered, only Congress can address the inherent conflict of attempting to serve both shareholders and a public mission. The new Congress and the next Administration must decide what role government in general, and these entities in particular, should play in the housing market. There is a consensus today that these enterprises pose a systemic risk and they cannot continue in their current form. Government support needs to be either explicit or non-existent, and structured to resolve the conflict between public and private purposes. And policymakers must address the issue of systemic risk. I recognize that there are strong differences of opinion over the role of government in supporting housing, but under any course policymakers choose, there are ways to structure these entities in order to address market stability in the transition and limit systemic risk and conflict of purposes for the long-term. We will make a grave error if we don't use this time out to permanently address the structural issues presented by the GSEs.

In the weeks to come, I will describe my views on long term reform. I look forward to engaging in that timely and necessary debate.

-30-

<<09-07-08 GSECF Fact Sheet.pdf>> <<09-07-08 PSPA Fact Sheet.pdf>> <<09-07-08 MBS Fact Sheet.pdf>>

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TAB 48

From: [Kevin Warsh](#)
To: [JNellie Liang](#)
Subject: Re:
Date: 09/12/2008 03:21 PM

Thx nellie for encouragement. I hope we dont protect anything!

--Sent from my BlackBerry Wireless Handheld

▼ [JNellie Liang](#)

----- Original Message -----

From: JNellie Liang
Sent: 09/12/2008 02:51 PM EDT
To: Kevin Warsh

Gov Warsh,
I know lots of balls in the air, but hope we don't have to protect
Lehman's sub debt holders.

Nellie

TAB 49

From: Wilkinson, Jim
Sent: Friday, September 12, 2008 3:35 PM
To: 'coxc@sec.gov'
Subject: Fw: FT - No Fed bail-out this time round

From: McLaughlin, Brookly
To: _DL_FYI
Sent: Fri Sep 12 15:21:33 2008
Subject: FT - No Fed bail-out this time round

FT - No Fed bail-out this time round

By Krishna Guha in Washington and Henny Sender in Hong Kong

Published: September 12 2008 15:28 | Last updated: September 12 2008 19:23

Six months ago the US authorities put \$29bn of public money at risk to help secure a rescue takeover of failing investment bank Bear Stearns by JP Morgan Chase.

Today the Treasury and the Federal Reserve refuse to put any public money on the table to help close a rescue takeover for Lehman Brothers, even though it is also an investment bank and it is bigger than Bear was. So what has changed?

People familiar with the US authorities thinking highlight three important differences between the crisis at Lehman today and that at Bear in March.

First, Lehman's business mix differs from Bear's.

While Lehman is bigger than Bear, it is less deeply involved in the systemically important credit default swaps market and clearing system.

Second, while the crisis at Bear stunned the markets, other financial institutions have had six months to prepare for the possible failure of Lehman. In the Bear crisis, the risks were extreme in part because they were unknown and unmanaged.

The New York Fed has conducted extensive stress tests in order to attempt to evaluate the impact of a Lehman failure on markets such as the CDS market and it believes the systemic risk is quantifiable and lower than the risk that was posed by the imminent collapse of Bear back in March.

Regulators have also evaluated the risk mitigation strategies put in place by other banks and the authorities believe them to be robust.

That suggests the risk that a Lehman collapse could trigger a domino effect of failures at other financial institutions ought not to be great.

Third, the Fed now has in place an emergency liquidity facility to guard against the risk that Lehman could suffer the kind of sudden funding strike in the repo market that sank Bear.

This should ensure that if Lehman does collapse, it does so in a slower and relatively orderly fashion, allowing it to wind down business operations in a way that does not cause sudden shocks to markets.

"Bear Stearns happened so quickly," says a former Fed official. "At the time, there was no infrastructure to keep Bear alive."

"Now there is an infrastructure to prevent a disorderly liquidation with the Fed willing to lend against good collateral."

But there may be other factors at play as well, over and above those the authorities highlight.

The Fed – while believing to this day that it did the right thing with the Bear Stearns rescue – was nevertheless not keen to repeat its prominent role in that operation, which former chairman Paul Volcker said stretched its legal authority to the limit.

In subsequent months, Ben Bernanke, chairman of the Fed, has made it clear – with the full support of Hank Paulson, US Treasury secretary – that the decision to risk taxpayers funds must always be very clearly made by Treasury, and the Fed should in this respect act only as the Treasury's operational agent. Mr Paulson, meanwhile, fresh from his giant rescue takeover of Fannie Mae and Freddie Mac, and with an eye on demands by car makers for billions in government subsidies, has had to take into account the danger that another financial sector rescue would promote a bailout culture.

Several Washington-based experts have argued Lehman did not endear itself to the authorities by walking away from earlier rescue proposals because it felt the prices on offer were too low.

"Lehman may be the poster child for enough-is -enough," says a senior executive at a private equity firm that has been in talks with Lehman in regard to possible asset sales.

Policymakers want to get away from the notion there was a standard formula for resolving financial crises – ie. deploy public money to keep the debt whole once the equity is all but wiped out – knowing this has sponsored specific destabilising trades in financial markets.

The US government may judge that – with a record budget deficit looming next year and Fannie and Freddie's \$5,400bn of liabilities now in public hands – its fiscal ammunition is not limitless, and it may be wise to keep some in reserve for what may prove to be many more such crises further down the road.

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Brookly McLaughlin

Deputy Assistant Secretary for Public Affairs

U.S. Treasury Department

1500 Pennsylvania Avenue, NW

Washington, D.C.

(202) 622-2920-office

TAB 50

From: Chairman
To: [Kevin Warsh](#)
Cc: [Donald L Kohn](#)
Subject: Re: RB presidents
Date: 09/12/2008 05:12 PM

We covered all the bases. Thanks for your help.


▼ [Kevin Warsh/BOARD/FRS](#)

Kevin Warsh/BOARD/FRS

To: Chairman BOARD/FRS@BOARD, Donald L Kohn/BOARD/FRS@BOARD

cc

09/12/2008 05:11 PM

Subject: Re: RB presidents 

Spoke with sandy, gary, tom -- they are all fine. Thx

--Sent from my BlackBerry Wireless Handheld

▼ Chairman Bernanke

----- Original Message -----

From: Chairman Bernanke
Sent: :39 PM EDT
To: Donald Kohn
Cc: Kevin Warsh
Subject: Re: RB presidents

Talked to Sandy but Kevin had reached her first. Kevin, did you talk to any other presidents?

▼ [Donald L Kohn/BOARD/FRS](#)

Donald L Kohn/BOARD/FRS

To: Chairman BOARD/FRS@BOARD

cc: Kevin Warsh/BOARD/FRS@Board

09/12/2008 04:23 PM

Subject: Re: RB presidents 

talked to Lockhart, Rosengren, Fisher. All seemed fine with LEH briefing, though I was quized closely by Fisher on the appetite for Fed/Gov't involvement beyond liquidity provision. I told him strong predilection against by both Treas. and Fed--were exploring the bankruptcy option as well as ways of involving private sector in wind down outside of bankruptcy--, but could give no 100% guarantees on what perception of situation would be Sunday evening. Only discussion on policy was with Fisher, who was fine with B; had some preference for a minor tweak in language, but couldn't remember what it was and didn't have statment in front of him. Brian later told me Fisher was ok with B language.

▼ Chairman Bernanke **BOARD/FRS**

Chairman
Bernanke **BOARD/FRS**

To Donald L Kohn/BOARD/FRS@BOARD

cc Kevin Warsh/BOARD/FRS@BOARD

09/12/2008 02:04 PM

Subject RB presidents

I briefed Plosser and Evans on LEH and also discussed ^{Material Redacted}. Both are comfortable both with LEH developments ^{Redacted Material}

I had previously talked to Lacker and Bullard. ^{Redacted Material}

I will speak to Yellen later this afternoon (^{Redacted Material})

I have briefed both Govs Duke and Kroszner on LEH and discussed ^{Material Redacted} with them briefly.

I am willing and able to make additional FOMC calls if needed.

TAB 51

From: Helen.Ayala@ny.frb.org
Sent: Friday, September 12, 2008 5:21 PM
To: Shafran, StevenDisabled
Subject: Fw: Delivery Status Notification (Failure)
Attachments: LEGALDOCS-#283273-v1-Lehman_Outline.DOC; mime.txt

----- Forwarded by Helen Ayala/NY:FRS on 09/12/2008 05:12 PM -----

postmaster@do.treas.gov

To helen.ayala@ny.frb.org

cc

09/12/2008 05:14 PM

Subject Delivery Status Notification (Failure)

To: steven.shafran@do.treas.gov
Subject: Financial Community Meeting

For your comments.

Thomas C. Baxter, Jr.
General Counsel and Executive Vice President
Federal Reserve Bank of New York

Speaking Notes

Financial Community Meeting

- We are facing the eventuality that a negotiated acquisition of Lehman is not likely before Asia opens.
- We need a realistic set of options from you to help limit the potential damage to the system. A sudden and disorderly unwind could have broad adverse effects on the capital markets, with a significant risk of a precipitous drop in asset prices, the widening of spreads, and reduced liquidity.
- The financial community needs to come together to fashion an orderly resolution of the current situation. As some here recall, we have precedent from the Fall of 1998 for this, when we addressed Long Term Capital Management.
- I cannot offer the prospect of containing the damage if that doesn't occur.
- The Fed is willing to be helpful in obtaining any necessary regulatory approvals and through access to existing liquidity facilities backed by the normal range of collateral.
- We do not, however, envision providing any form of extraordinary credit support in this operation. We believe that this should be primarily a private sector initiative.
- While we do not have a particular proposal for you, we believe capital is required so as to provide Lehman the time to reorganize its activities in an orderly manner. An acceptable proposal must provide confidence to

encourage Lehman's creditors/counterparties not to run. If a proposal along these lines cannot be crafted this weekend, the only alternative may be a bankruptcy filing covering some or all of the Lehman entities.

- We have a large team of people working on the measures that may need to be taken to mitigate some of the market disruption that might flow from such a bankruptcy filing. We welcome the leadership of market participants such as yourselves in developing a realistic set of options to help limit the damage to the financial system. As you know, however, we do not have the tools that would allow us fully to contain that disruption.

TAB 52

AIG Meeting Notes

September 12, 2008

AIG – Jacob Frenkel (Vice Chairman), Steve Bensinger (CFO), David Herzog (SVP & Comptroller), Robert Gender (VP & Treasurer), Alan Pryor (EVP – Financial Services Division)

FRBNY – Trish Mosser, Jim Mahoney, Bill Dudley

AIG is facing serious liquidity issues that threaten its survival viability.

There are potential credit rating agency downgrades. Moody's Committee meets on Monday September 15 (currently rated AA3, downgraded at least one notch)... S&P already has AIG on negative watch (as of today)... Fitch already has AIG on negative watch.

Rating triggers:

GICs are issued out of AIG-Financial Products (AIG-FP), insured by the holding company.

- downgrade by 1 rating agency leads to \$10B in collateral calls, plus an additional \$4B-\$5B in portfolio obligations that are puttable if downgraded (total of \$15B in liquidity needs)
- downgrade by 2 rating agencies – additional \$3B in liquidity needs
- If downgraded, they must post half of the additional collateral within 2 days, and the other half in 10 days.

Markets are also punishing AIG. Stock prices are off about 40% today, and CDS is traded at about 1400 bp (up from about 10 bp eighteen months ago).

Some banks are already pulling away; some banks are even turning down AIG in the secured (repo) borrowing markets

AIG is having problems rolling its commercial paper (CP). \$2.5B in CP matured today, but they were able to roll only \$1.1B, the remaining \$1.4B was funded out of the parent.

AIG has a total of about \$15B in CP, which has backstop (backup lines of credit) from a consortium of banks; AIG may have to draw on lines on Monday, which is a material event and so will become publicly known and have negative implications.

AIG also has ABCP facilities of about \$5B, and these have no backup lines

AIG's repo book is all investment grade, mostly structured mortgage products.... Things that have, in the past, been used as repo collateral... but the combination of being perceived as a weak counterparty and risky, illiquid collateral is resulting in counterparties stepping away....

Securities lending (mostly out of the insurance companies) – about \$69B in liabilities, and the holding company has only enough cash to fund ½ of that, if the securities lending counterparties turn away from the AIG name.

Mobility of liquidity – most cash within the organization is ‘trapped’ in regulated entities and is not freely transferable to AIG holding company or AIG Financial Products (the derivatives and trading sub) for its liquidity needs.

Today, the holding company started with \$9B in liquidity, used \$1.4 for CP, but was able to upstream about \$1.4B in ‘dividends’ from subs up to holding company, but little ability, in general, to use subs to upstream liquidity to holding co or its non-regulated subs.

Bottom line: Treasurer estimates that parent and AIG FS sub have 5-10 days before they are out of liquidity.

Plans to address liquidity stress? AIG is aggressively pursuing:

- Asset sales – but many viable assets to sell have distressed and illiquid markets into which to sell
- Equity issuance – not viable at this time – 3 months ago, AIG raised \$20B in capital. It is all gone.
- Holding company has about \$12B in ‘Fed-eligible’ assets (that is, PDCF collateral... note, however, this does not include the restriction on assets that have ‘available prices’)
- The various insurance subs have very large quantity of high quality assets, but the restrictions on pledging those are very unclear.

Unwinding in event of bankruptcy is likely to be very messy, because derivatives book is large and complex \$2.7 Trillion, largely of very long-term structure products. \$1 Trillion is concentrated in 12 large counterparties. Book is very far from balanced, although they could not give a MTM value. One of the challenges they are already facing is very aggressive marks from counterparties and strategic unwinding of “in the money” positions, and this will likely accelerate in coming days adding to the cash drain. Their super senior CDO book is about \$80 bn and at present they have approximately \$19 billion in collateral posted against it.

Access to Fed facilities:

They have what they describe as a very small thrift, and so limited ability to borrow from DW. Recently they drew up a plan to become a primary dealer over a 6-12 month period, but obviously do not have the time to implement that plan. They explicitly asked about how to obtain an IPC 13-3 loan. They are very willing to open their books to us, and give us a better sense of their risk profile, the complexity of their book and detailed liquidity profile as soon as possible (ie this weekend.)

TAB 53

From: Mark.VanDerWeide@frb.gov
To: Lucinda.Brickler@ny.frb.org
Cc: [Chris.McCurdy](mailto:Chris.McCurdy@ny.frb.org); Patrick.M.Parkinson@frb.gov
Subject: Re: triparty repo thoughts for this weekend
Date: 09/13/2008 10:53 AM

A few comments/questions. Since your paper last night was probably 1-2 steps behind TFG, my comments this morning are probably 3-4 steps behind.

Option 1: need to discuss whether this fits within existing PDCF authorization or would need to be new 13(3)/10B loan (like the Bear March 14 loan).

Option 2: need to understand factually how the JPMC/FRBNY sharing would work and how the "shell" works. Some concern about the nature of the legal entity to which the FRBNY would have credit exposure.

Option 4: need to better understand how this credit facility would work.

Mark (202-452-2263)

Lucinda.Brickler@
ny.frb.org
To
09/12/2008 11:04
PM

Patrick.M.Parkinson@frb.gov

cc

"Donald Kohn"
<Donald.L.Kohn@frb.gov>, "Kevin
Warsh" <Kevin.Warsh@frb.gov>, "Mark
VanDerWeide"
<Mark.VanDerWeide@frb.gov>, "Chris
McCurdy" <Chris.McCurdy@ny.frb.org>
Subject
Re: triparty repo thoughts for this
weekend

Pat

Thanks. I think there has been much concern raised about maintaining the rate and perhaps also with retaining capacity to expand the existing programs if needed. There has also not been much appetite over the past few days for ideas that involve extending public support beyond the existing programs. These issues and speculation about how bankruptcy would likely unfold are the drivers of this thinking.

The situation is fluid, however. The notes I have been sending are intended to test ideas and generate dialog. They seem consistently one or more steps behind TFG. So let's see how the situation evolves over the weekend and raise the appropriate concerns and recommendations. It's good that you'll be here. Safe travels.
Lucinda

Sent from my BlackBerry Wireless Handheld

----- Original Message -----

From: Patrick M Parkinson

Sent: 09/12/2008 08:49 PM EDT

To: Lucinda Brickler

Cc: Chris McCurdy; Mark VanDerWeide; Donald Kohn; Kevin Warsh

Subject: Re: triparty repo thoughts for this weekend

Lucinda,

I have attached some comments, but I am not sure they will be helpful. I'm forced to guess why plans have changed. I assume the fundamental problem is that even after the parent files for bankruptcy, the SEC wants the b/d to live on and does not want us grabbing tri-party collateral and paying off investors? And/or that we don't want to take OMO collateral because we can't rehypothecate and funds rate would go to zero?

In any event, this now looks to me like a godawful mess.

Pat

[attachment "triparty Cheat Sheet 9 12-15 parkinson comments.doc" deleted by Lucinda M Brickler/NY/FRS]

Lucinda M
Brickler/NY/FRS@F
RS
Sandy.Krieger@ny.frb.org,
09/12/2008 06:45
PM

To

Chris.McCurdy@ny.frb.org, Patrick M
Parkinson/BOARD/FRS@BOARD, Mark
VanDerWeide/BOARD/FRS@BOARD, Joseph
Sommer/NY/FRS@FRS, HaeRan
Kim/NY/FRS@FRS, Chris
Burke/NY/FRS@FRS, Susan
McLaughlin/NY/FRS@FRS, William
Dudley/NY/FRS@FRS, Meg
McConnell/NY/FRS@FRS

cc

Subject
triparty repo thoughts for this
weekend

Hi

Attached are some thoughts on triparty repo for the weekend. I've attempted to capture everyone's positions and concerns, so we're all on the same page as we think about options. I've also attempted to briefly describe a few things we may need to consider in the event that JPMC refuses to unwind Lehman's positions on Monday--assuming they're still in business, but haven't been rescued--and the policy makers believe an intervention is necessary to protect the market from the fallout of a sudden default. As always, your thoughts, questions, etc., are welcome. We obviously have some work to do if we think we want to consider options that go beyond the existing facilities.

ttys

Lucinda
[attachment "triparty Cheat Sheet 9 12-15.doc" deleted by Patrick M
Parkinson/BOARD/FRS]
Lucinda Brickler
Payments Policy Function
Federal Reserve Bank of New York
212.720.6132 or 646.720.6132

TAB 54

From: Helen.Ayala@ny.frb.org
Sent: Friday, September 12, 2008 5:21 PM
To: Shafran, StevenDisabled
Subject: Fw: Delivery Status Notification (Failure)
Attachments: LEGALDOCS-#283273-v1-Lehman_Outline.DOC; mime.txt

----- Forwarded by Helen Ayala/NY:FRS on 09/12/2008 05:12 PM -----

postmaster@do.treas.gov

To helen.ayala@ny.frb.org

cc

09/12/2008 05:14 PM

Subject Delivery Status Notification (Failure)

To: steven.shafran@do.treas.gov
Subject: Financial Community Meeting

For your comments.

Thomas C. Baxter, Jr.
General Counsel and Executive Vice President
Federal Reserve Bank of New York

Speaking Notes

Financial Community Meeting

- We are facing the eventuality that a negotiated acquisition of Lehman is not likely before Asia opens.
- We need a realistic set of options from you to help limit the potential damage to the system. A sudden and disorderly unwind could have broad adverse effects on the capital markets, with a significant risk of a precipitous drop in asset prices, the widening of spreads, and reduced liquidity.
- The financial community needs to come together to fashion an orderly resolution of the current situation. As some here recall, we have precedent from the Fall of 1998 for this, when we addressed Long Term Capital Management.
- I cannot offer the prospect of containing the damage if that doesn't occur.
- The Fed is willing to be helpful in obtaining any necessary regulatory approvals and through access to existing liquidity facilities backed by the normal range of collateral.
- We do not, however, envision providing any form of extraordinary credit support in this operation. We believe that this should be primarily a private sector initiative.
- While we do not have a particular proposal for you, we believe capital is required so as to provide Lehman the time to reorganize its activities in an orderly manner. An acceptable proposal must provide confidence to

encourage Lehman's creditors/counterparties not to run. If a proposal along these lines cannot be crafted this weekend, the only alternative may be a bankruptcy filing covering some or all of the Lehman entities.

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TAB 55



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Three days that shook the world

Exactly three months ago, the collapse of Lehman triggered a global financial panic. Fortune examines what happened in the 72 hours when the world's most powerful bankers met to try to save Lehman and wound up changing the face of Wall Street forever.

By William D. Cohan

Last Updated: December 16, 2008: 4:10 PM ET

NEW YORK (Fortune) -- When the most powerful people in American capitalism convened at the New York Federal Reserve Bank's Italianate palazzo in lower Manhattan on Friday evening, September 12, to try to save Lehman Brothers from certain death, what confronted them was nothing less than the knowledge that whatever actions they took - or did not take - that weekend could push the financial system into the abyss.

Over the next stressful 72 hours, CEOs and their top deputies from Goldman Sachs ([GS](#), [Fortune 500](#)), Merrill Lynch, Morgan Stanley ([MS](#), [Fortune 500](#)), JPMorgan Chase ([JPM](#), [Fortune 500](#)), Citigroup ([C](#), [Fortune 500](#)), Credit Suisse and other firms worked alongside Treasury Secretary Hank Paulson and Timothy Geithner, then the president of the New York Federal Reserve and now Barack Obama's choice to replace Paulson at Treasury. Three months to the day that the bankers emerged from that fateful weekend, though, it is clear that the ideals and egos of the participants in those meetings have reordered the American business landscape.

On Friday September 12, there were four major investment banks. Today, there are none recognizable as such. On that Friday, the Dow closed well above 11,000. Today, it is 3,000 points lower. On September 12, a form of "compassionate conservatism" was still the doctrine of the Bush administration.

Today, the federal government has nationalized Fannie Mae, Freddie Mac and AIG. It has bailed out banks with hundreds of billions of dollars of taxpayer money, purchased some of their most toxic assets, and no one is sure where this blurring of the lines between the public and private sector will end. By turning the clock back and looking at what transpired during that weekend, one can see how a transformation of the U.S. financial industry occurred almost in a flash, with the consequences unknown even to people in the room.

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FISHER INVESTMENTS

"We went into the weekend knowing it was very dark," explained a government official. "There was nobody that was part of this process that did not believe the world was exceptionally fragile and that Lehman was systemic and that the consequences of its default would be traumatic. There was nobody in that room - from the Treasury, the Fed or from the Federal Reserve Board or from the private sector - that could have told you exactly what would happen or what the consequences would be. And I made it clear over and over and again in that room that if we didn't solve this, everything else would be harder to deal with. Solving this was not going to make all the other problems go away but we did not feel we had the ability to insulate the markets from the broader consequences of default."

FRIDAY EVENING SEPTEMBER 12 Paulson pulls the fire alarm

Henry Paulson, the Treasury secretary, and Christopher Cox, the chairman of the SEC, flew up from Washington on Friday for a 6 p.m. meeting with Geithner to discuss what the plan for the weekend would be. Meanwhile, Ben Bernanke, the chairman of the Federal Reserve, stayed in Washington to coordinate a response with the leaders of other central banks around the globe. Going into the weekend, there were two potential suitors for Lehman Brothers - Bank of America and London-based Barclays. With Geithner at his side, at 6:15 p.m., Paulson stood before the assembled Wall Street CEOs and delivered a harsh message, according to a source there. "There will be no bailout for Lehman," Paulson said. "The only possible way out is a private-sector solution."

At that moment, Ian Lowitt, Lehman's CFO since June 2008, knew it was over for his firm. That night "[government] officials...indicated that emergency federal funding would not be forthcoming to stabilize Lehman Brothers and provide the liquidity needed for its operations," he wrote in an affidavit accompanying the firm's September 15 bankruptcy filing.

Unlike what the government did for Bear Stearns, in March, there would be no taxpayer money made available to support a Lehman bailout. According to one government official, there was a lot of rhetoric going into the weekend both from the Congress and from people around the Treasury about how the solution for Lehman should not involve public money. Whether that was a clever negotiating tactic or the line in the sand that would not be crossed, the Treasury secretary had set the definitive tone for the weekend. The future of Lehman Brothers, a 158-year-old firm with origins as a dry-goods store and cotton trader in Montgomery, Alabama, rested solely with the people sitting around the table in the Fed's ornate boardroom at 33 Liberty Street. Come up with a private market plan in 48 hours to save the firm from insolvency or suffer the consequences of a catastrophic unwind of Wall Street's complex and internecine financial relationships.

After Paulson announced that there would be no government bailout for Lehman, he and Geithner laid out three possible contingency plans for the titans of Wall Street to work on during the weekend. Door Number One: Investigate whether there could be a "private-sector liquidation consortium" that would somehow finance a gradual sale of Lehman's assets outside of bankruptcy. Door Number Two involved the assembled bankers closely examining Lehman's most damaged assets and then forming a consortium to finance those that neither Bank of America nor Barclays wanted to take, allowing an acquisition of the remainder of Lehman to occur. Door Number Three was to contemplate how the free world could contain the damage in the event there was no solution possible. The first idea quickly became untenable and nobody, at the outset, had the slightest interest in seriously considering the third scenario.

The focus of the meetings became how to finance the Lehman assets that neither Bank of America ([BAC](#), [Fortune 500](#)) nor Barclays ([BCS](#)) wanted. (Representatives of Bank of America, Barclays and Lehman were in and around the Fed that weekend but were not included in many of the meetings of the wider group because of their stake in the outcome.)

LATE FRIDAY NIGHT Bank of America bows out

Earlier in the week, Paulson had called Ken Lewis, the CEO of Bank of America, and asked him to take one for the team by looking seriously at buying Lehman. (Some people believe that Paulson also gave his former colleagues at Goldman Sachs an early peek at the Lehman books, too.) Representatives from Bank of America flew up from its corporate headquarters in Charlotte, North Carolina and met with Lehman bankers at the midtown offices of Sullivan & Cromwell, Lehman's legal advisors. Bank of America spent a few days reviewing Lehman's

\$85 billion book of commercial and residential real-estate loans. "We figured that the \$85 billion in troubled loans was at least \$10 billion underwater," Lewis told Fortune (see "[A visit with Bank of America CEO Ken Lewis](#)"). He doubted the value of Lehman's better assets - its investment-banking and asset-management businesses - would cover the \$10 billion hole. He proposed to Paulson - in a late-night phone conversation - that the government take around \$65 billion off Lehman's books. Without that level of assistance, Bank of America couldn't consider buying Lehman.

But the Bank of America proposal was beyond what the Fed or Treasury could realistically consider given the nature of the assets Lewis wanted the Fed to finance and because it was more than twice the \$29 billion secured loan the Fed had made to JPMorgan to facilitate its acquisition of Bear Stearns. When Paulson told Lewis the government wouldn't help, Lewis put his pencil down - for the moment. He did come to New York that weekend but would never become part of the meetings at the Fed.

SATURDAY MORNING Lehman's books get scrubbed

With Bank of America out of the mix, the bankers at the New York Fed examined a proposal by Barclays, whereby the British bank would acquire all of Lehman except for the firm's commercial real-estate asset book, which had a face value of \$40 billion (before writedowns).

The assembled bankers spent much of Saturday poring over Lehman's commercial real-estate portfolio in hopes of finding a way to finance the \$40 billion of assets that Barclays did not want to acquire. The dodgy assets left behind needed a layer of equity underneath them for the remaining entity to have any hope of viability. According to a participant in the weekend's fevered meetings, Lehman had 2,400 real estate "positions."

Lehman CEO Richard Fuld and Lowitt had announced on the previous Wednesday that the commercial real-estate assets would be marked down to \$33 billion - from \$40 billion. But, on Saturday, as mortgage-securities experts from Citigroup, Credit Suisse, Deutsche Bank and Goldman Sachs analyzed the portfolio, they quickly realized, according to one participant, "the effective marks on the assets should probably have been \$12 billion lower," or \$21 billion, rather than \$40 billion, almost a 50% discount to their marked value (notwithstanding the Wednesday revision). "There wasn't a disagreement among the group about what the write-down should be," he said.

But there was some disagreement about the \$21 billion valuation depending on whether some institutions would have to mark them to market. As a compromise, the four banks instead recommended to the other banks in the consortium that Lehman's real-estate portfolio be valued at around \$25 billion. The hole the consortium of banks had to fill was closer to \$15 billion, meaning that each one would need to provide around \$1 billion to finance the commercial real-estate assets left behind by Barclays in what would remain of Lehman Brothers. The banks also knew that they would have to take a write-down on their loans as the assets were sold into the market over time. But to facilitate the Barclays deal they were willing to do it. "There was a real concern that the demise of Lehman would lead to real problems for everybody else," one banker said.

SATURDAY AFTERNOON Thain gets busy

While most of Wall Street was hunkered down at the New York Federal Reserve to review Lehman's books, Greg Fleming, the president of Merrill Lynch and a former financial institutions banker, had been urging his boss, John Thain, Merrill's CEO, to call Ken Lewis to talk about a deal between the two firms. Fleming had grown concerned during the week as Merrill's stock fell to \$17.05 per share, from \$28.50 per share. Fleming also knew that Lewis had long coveted Merrill Lynch and that Fleming's previous boss, Stan O'Neal, had no interest in such a deal. "It's an iconic name," Lewis told Fortune about Merrill Lynch and the "one company" he wanted "to round out" his strategic vision for Bank of America. He said owning Merrill Lynch "would give us a major presence in investment banking as well as wealth management."

Thain, who had been at the Fed on Friday night, knew by Saturday morning that Bank of America was out of the hunt for Lehman, and he had also decided that Lehman was not going to be saved. If Lehman declared bankruptcy, he figured Merrill would be the next domino to fall. He had watched the group of bankers "pummel" Bart McDade, Lehman's president, with questions about Lehman's assets "and decided he did not want to be next," according to a banker there. "It became clear to me that it would make sense to explore options for us," Thain said

in the press conference after announcing the deal.

Thain got Lewis' cell phone number from Fleming, stepped out of the meeting and called the Bank of America CEO. "We began to talk about the opportunity over the phone," Lewis said. "Then a few hours later, we were talking about it in person." Rumors began circulating at the New York Fed that Thain and Lewis were talking about a deal. In the interim, Lewis flew up by private jet from Charlotte to New York. They agreed to meet secretly in Bank of America corporate-owned apartment at the Time Warner Center, at Columbus Circle. "It didn't take but about two seconds to see the strategic implications or [the] positive implications" of the deal, Lewis said. "It was obviously a fairly short period of time, very intense and we saw a lot of each other." Following his call to Lewis, Thain said the two men "quickly" realized "the strategic combination made a huge amount of sense, and the opportunity to put this transaction together really was [so] unique that we both decided we wanted to take the opportunity." The code name for the deal was "Project Alpha."

At his side as an advisor Lewis had J. Christopher Flowers, the head of his own private-equity firm that specialized in financial services. Flowers, an ex-Goldman partner, seemed to have examined the books of nearly every Wall Street firm by September 2008, including Bear Stearns and Merrill Lynch. "[Flowers] had done quite an amount of due diligence on Merrill Lynch fairly recently," Lewis said. "It was very, very extensive. They had looked at the marks very comprehensively. This allowed us to have him and his team as an advisor, and just update the information they already had. That was one of the key ingredients to being able to do this as quickly as we did." Flowers was very complimentary of what Thain and his team had done in terms of shedding assets including Merrill's 25% stake in Bloomberg and a \$30.6 billion portfolio of troubled, mortgage-backed securities for 22 cents on the dollar.

Lewis determined he had to move quickly to win Merrill. Not only had he wanted to own the firm for years, he also was aware that Goldman Sachs and Morgan Stanley were in the mix. Merrill had reached out to Morgan Stanley about a deal. Morgan Stanley passed quickly - reportedly because the firm decided there simply was not enough time. Separately, on Saturday morning at the Fed, representatives of Goldman Sachs reached out to former Goldman partner Peter Krause, Merrill's newly recruited head of strategy, to see whether Merrill would consider allowing Goldman to make a 9.9% minority investment in Merrill. This set off a heated debate - according to someone who witnessed it - between Krause and Fleming about whether Merrill should pursue the Goldman deal or the Bank of America deal. For Goldman, the idea was to save a rival and to keep the fury of the looming storm at bay. "I think about it in terms of the Great Barrier Reef," one Goldman executive said. "If you think of Bear as being an outlying piece of coral at the far eastern extremity of the reef. Then Lehman is a bit closer in and then Merrill is a bit closer. Then Morgan Stanley and Goldman Sachs are on the beach but still pretty close to the water. When you have a tsunami coming in, it's getting to be pretty uncomfortable."

SATURDAY NIGHT The gloves come off

Merrill and Bank of America executives were closing in on an all-stock deal, in which Merrill shareholders would receive \$29 per share in Bank of America stock, which valued Merrill at \$50 billion, a 70% premium to where Merrill's stock had closed the previous Friday. Meanwhile, back at the Fed, tempers started to flare. The assembled bankers were still wrestling with how to value the Lehman real-estate assets that Barclays wanted to leave behind. "It was a question of how much equity we needed to put up," one banker said, "to make the Barclays deal fly." This led to increasing tensions on all sides. At one point, late Saturday night, Gary Shedlin, a M&A banker at Citigroup, faced off against his old boss, Michael Klein, who was there representing Barclays and his client, Archibald Cox Jr., who was appointed chairman of Barclays Americas in April 2008.

"How much equity do you need to raise to do the deal?" Shedlin asked Klein.

"Why is that important?" Klein shot back. "Why do you need to know that?"

"You're making an offer for this company and we've got to know how you're going to finance it," Shedlin countered.

"We will not have to raise any incremental capital as part of this transaction," Klein said definitively. The two men glowered at each other before turning to less confrontational matters. (Shedlin confirmed the exchange to Fortune;

Klein did not respond to requests to be interviewed.)

Bankers worked most of the night to put together a term sheet for how they would all agree to support Barclays' acquisition of most of Lehman Brothers. Some banks - such as BNP-Paribas and Bank of New York - were not so sure they wanted to participate, causing Jamie Dimon, the CEO of JPMorgan Chase to admonish them. "You're either in the club or you're not," he said, according to one banker. "And if you're not you'd better be prepared to tell the secretary why not." Still, a deal seemed close.

SUNDAY MORNING A flag on the play

On Sunday morning, the executive group re-assembled at the Fed at nine o'clock. "Everything was ready to go on Sunday morning," one participant said. "People were happy with the term sheet, so there was a doable deal on the table." Steve Shafran, a senior advisor to Paulson and an ex-Goldman Sachs partner, told a group of Lehman Brothers executives at the Fed that morning, "It looks like we may have the outlines of a deal around the financing." After which, the Lehman bankers thought they had saved their firm.

The Barclays deal required the blessing of the Financial Services Authority, in London - the UK equivalent of the SEC. So Paulson spoke with his UK counterpart, Alistair Darling, the Chancellor of the Exchequer, and to the FSA. He then summoned McDade, Lehman's president, to the New York Fed and told him at around 9:45 a.m., "Deal's off. The FSA has turned it down." At roughly 10 o'clock, Paulson and Geithner briefed the bankers at the Fed.

The FSA would not comment on its decision, but a number of the participants at the Fed on Sunday morning said the reasons given to them by Paulson for the FSA's rejection ranged from "the overall size of the potential exposure that Barclays was taking on and whether Barclays was in good enough shape to do it" to the fact that the "FSA was looking for some kind of a cap to avoid U.K. contagion, and the Fed had just said, 'No assistance for Lehman.' The FSA then concluded based on the amount of diligence, the risk profile, and the lack of any assistance from the U.S. that they were not going to let it proceed." There was also the suggestion made that Barclays "wasn't really that serious about getting FSA approval" going into the weekend knowing that there might be an opportunity to buy what it wanted from Lehman later at a lower price. (Barclays did not make its senior officials involved with the Lehman deal available for comment.)

The Lehman team was devastated by the news. "We thought we had a trade and felt good about it and thought we were in the right place," explained a Lehman banker, "and then to have the rug pulled out from under us after we were led to believe that the Street was there on the financing, it was just horrifying from our perspective." The stunned Lehman team returned to their headquarters at 745 Seventh Avenue to plot its next moves.

Paulson then told the remaining bankers, according to one, "Let's start talking about what the world will look like if Lehman goes under. Let's focus on a solution for stabilizing the markets." Among the people still present for Paulson's Sunday morning speech was John Thain. After Paulson and Geithner left the executives to contemplate what they could do as a consortium to keep the world's markets from collapsing completely, the assembled alpha males began talking about Merrill Lynch in front of Thain, as if he weren't there. "Merrill could be the next to go," one banker said. "And Thain wasn't saying anything," a participant said. "If Thain hadn't been there that morning, the rumors really would have been flying," Shedlin said. A few minutes later, Thain got up and left the room "and he never comes back," one participant said. Thain and his team were focused on negotiating a deal with Bank of America. Merrill had planned to meet with Goldman on Sunday morning but by this time Merrill had stopped returning calls to Goldman Sachs.

After Thain, Paulson and Geithner had left the New York Fed Sunday morning, the following exchange ensued, according to several sources who were there. John Mack, the CEO of Morgan Stanley, spoke up. "Maybe we should let Merrill go down too," he said.

Aghast, JPMorgan Chase's Dimon pointed out how shortsighted that was of Mack because Morgan Stanley might be the next firm that counterparties lost faith in. "John, if we do that, how many hours do you think it would be before Fidelity would call you up and tell you it was no longer willing to roll your paper?" Dimon's comment quieted Mack. "We thought Mack said that because he might be buying Merrill," Shedlin said, and wanted to buy

the firm on the cheap. (Mack denied he made the comment through a spokesman. A spokesman for Dimon said Dimon did not remember having the conversation with Mack).

The group quickly began refocusing on putting together what became an agreement that every firm in the room would continue to do business with every other firm in the room and would underwrite a multi-billion-dollar credit facility for the firms to use in an emergency in the wake of the presumed Lehman bankruptcy. "We figured all hell would break out the next day," one banker said. "And everyone else thought so too. Everyone was then focused on netting out their derivatives positions starting right then."

SUNDAY AFTERNOON Paulson tells Lehman where to go

Back uptown, at Lehman, Fuld and McDade were making frantic calls to whoever would listen to their pleas for help, including Paulson, Cox and Geithner. "But it crystallized in the course of the afternoon that it didn't look like they were going to do anything for us," a senior Lehman official said, despite Fuld's belief after having dinner with Paulson in April that "we have huge brand with [T]reasury." Calls also went out to Lehman's internal restructuring group, to Harvey Miller, the lead bankruptcy counsel at the New York law firm Weil, Gotshal & Manges and to Barry Riddings, a vice-chairman of Lazard and a restructuring expert, that the end was near and the bankruptcy papers - most likely for Chapter 7 liquidation - needed to be prepared.

There was little other choice, since there was no buyer and no deal to do. "We walked into that weekend," Fuld told Congress on October 6, "[and] I firmly believed we were going to do a transaction. I don't know this for a fact, but I think that Lehman and Merrill Lynch were in the same position on Friday night and they did a transaction with Bank of America. We went down the road with Barclays. That transaction, although I believe we were very close, never got consummated."

For his part, Geithner regretted that the FSA decision did not come sooner. A similar decision rendered on Friday would have given everyone assembled at the Fed that weekend more time to fashion another solution. But by Sunday, the clock had run out. If Barclays had been able to deliver, or if the banks had come up with a private sector solution for liquidating Lehman's assets in an orderly way, the Fed could have stepped in. Under those circumstances, it would have had the legal authority to do a deal similar to one it did to facilitate JPMorgan's acquisition of Bear Stearns by lending \$29 billion against a pool of Bear Stearns' assets that JPMorgan did not want.

With Lehman Brothers, there was nothing like that on the table. That was one very big difference from the Bear Stearns situation, where JPMorgan wanted to buy the company. Central banks do liquidity; they don't do insolvency, is how Geithner viewed the Fed's role. He felt he did not have the authority to pump capital into Lehman while it was in free fall and Lehman's assets were deemed to be of a lower quality than those of Bear Stearns the Fed financed for JPMorgan (and which have already lost \$2.7 billion in value as of October 23). Bernanke and Paulson would get that authority only after approaching Congress to seek approval of what became the \$700 billion bailout bill - a bill whose passage was undoubtedly conceivable only in the wake of fall-out in the stock market that followed Lehman's collapse.

McDade and Lowitt, on Lehman's behalf, made one last-ditch effort to convince Paulson that taxpayers should bail out Lehman. They went back down to the Fed and walked the Treasury secretary through a doomsday presentation that Lehman had put together foretelling the likely global consequences in various markets - foreign exchange, swaps and derivatives, among others - if Lehman were allowed to fail. After McDade finished, Paulson told him, "You're talking your own book. We've thought this over."

Paulson not only told McDade and Lowitt that Lehman had no choice but to file for bankruptcy, he also apparently told them the firm had to file for Chapter 7 liquidation by 7 p.m. Sunday night. That would mean a court-appointed trustee would take over the firm, the firm's doors would be locked, and its assets sold as rapidly as possible. By the time McDade and Lowitt returned to the 31st floor of 745 Seventh Avenue, the Lehman board of directors had assembled to vote on the bankruptcy filing. But the directors had decided to hold off until McDade and Lowitt had returned from the Fed with their report. Since McDade had taken over as president of the firm in June, he had displaced Fuld as the firm's day-to-day leader.

"The words," remembered one participant in the meeting, "that Bart used when he came into the board meeting were that 'We were mandated to file. We were mandated to file.' He was very, very, very clear on that." Some shocked board members wanted to know what that meant. What if the board decided to defy Paulson and not file for bankruptcy protection?

Because the Fed controlled Lehman's access to the money it needed to open for business the next day, the point was moot. But then lawyer Harvey Miller had an idea. "They can tell us to do it," he told his client. "But they can't tell us when. And they can't tell us what form." The Weil Gotshal team began preparing for a Chapter 11 filing - a reorganization plan, not a liquidation plan - for the Lehman Brothers parent company allowing the operating subsidiaries, such as the broker/dealer and the asset management business, to continue operating outside of bankruptcy. In the scheme of things, it was a technicality, but it allowed Lehman a modicum of leverage and the chance to tweak Paulson.

But Lehman's ordeal that Sunday night was far from over. First came a tantalizing ray of hope with the word that the Federal Reserve Board agreed to expand the collateral that investment banks could pledge to the Fed as part of both the Primary Dealer Credit Facility - the name given to the historic measure that allowed investment banks to borrow directly from the Fed window after the demise of Bear Stearns on March 16 - and the Term Securities Lending Facility, a \$70 billion "collateralized borrowing facility" created on Sunday by banks to enhance liquidity in the marketplace.

When the Lehman executives started to hear on Sunday afternoon that these windows of emergency financing were opening up, they called the New York Fed to see if it were true. If the Fed allowed Lehman to pledge its shaky collateral to the discount window "we might get a reprieve," one Lehman banker said. But the Fed told Lehman, according to this Lehman banker, "'Yeah, we're doing that for everybody else but you. We're going to let you guys go.'"

MONDAY MORNING Lehman throws in the keys

At close to midnight, Mark Shafir, Lehman's global head of M&A, and Mark Shapiro, the head of Lehman's restructuring practice, went to see Fuld in his 31st floor office. They told Fuld there was a way Barclays could buy Lehman's U.S. securities business out of bankruptcy, which would get Barclays what it really wanted and potentially save 10,000 jobs. The three men called Bob Diamond, Barclays' president and chief negotiator on the Lehman deal, on his cell phone. Diamond expressed his disappointment to them that Barclays had failed to get a deal done earlier in the day but when the men suggested to him he could buy Lehman's U.S. securities business "clean," he expressed great interest but needed to talk to his lawyers at Cleary, Gottlieb.

When Diamond called back, twenty minutes later, he told them, "I can't talk to you tonight. Call me at 7:00 in the morning."

By that time - at 1:45 a.m. to be precise - Lehman Brothers Holdings, Inc. had filed for Chapter 11. After the bankruptcy filing, the Fed agreed to lend money to Lehman's broker/dealer to allow it to keep operating for 24 hours, by which time a deal with Barclays could possibly be reached. At 7 a.m. Monday morning, as the calamitous effect of Lehman's bankruptcy began spreading virally to financial capitals all over the globe, Diamond and Michael Klein, his financial advisor, got on the phone with Fuld, McDade, Shafir and Shapiro to discuss the possibility of Barclays buying Lehman's U.S. investment banking business. Based on the due diligence work Barclays had already done on Lehman, "they were the only guys able to pick up the pieces of the melting ice cube," Shedlin said. The Lehman team told Klein and Diamond, "We absolutely have to get this done before the [markets] open on Tuesday because we're out of money."

With that, Fuld told Shafir to "Go finish it." For the next 24 hours, swarms of lawyers and bankers took over the 32nd floor of Lehman's building. The terms of the deal had to be negotiated, which required a fast-track appraisal of Lehman's headquarters building at 745 Seventh Avenue and two data centers in New Jersey that Barclays wanted to buy. Barclays wanted all of Lehman's U.S. investment banking, fixed-income, equity sales-and-trading, research and certain support functions. Barclays did not want the investment management division nor any of the commercial real-estate assets.

The plan had been to announce the deal before the market opened Tuesday morning and Lehman's broker/dealer subsidiary ran out of cash to operate. Finally, just as the market was opening, the terms of the deal were agreed: Barclays would buy the Lehman businesses it wanted for \$250 million and pay another \$1.45 billion for 745 Seventh Avenue and the two data centers (later the package was reduced to \$1.29 billion) plus assuming some of Lehman's trading obligations. Barclays also agreed to provide a \$500 million debtor-in-possession facility to the bankrupt holding company and also to refinance the \$40 billion or so Lehman's U.S. broker/dealer had borrowed from the Fed after the filing to keep operating.

With that in hand, Barclays asked the FSA for its blessing. According to a Lehman executive, "It took four hours to get out of the FSA, and we thought, 'Here we go again. They're going to turn it down and we're going to be facing a Chapter 7 liquidation anyway.'"

AFTERMATH

At around 1 p.m. Tuesday, the FSA signed off and Barclays announced it had bought much of Lehman's business in the U.S., subject to bankruptcy court approval, which was granted - on an extremely expedited basis - on Friday, September 19. "Lehman Brothers became a victim," Judge James Peck said in approving the deal. "In effect, the only true icon to fall in the tsunami that has befallen the credit markets. And it saddens me."

In the days following the collapse of Lehman Brothers, the government came to the rescue of AIG - eventually to the tune of \$150 billion; created the TARP - the Troubled Asset Relief Program - for \$700 billion; and saved Citigroup by pumping in \$45 billion in equity and effectively underwriting \$306 billion in toxic assets (Citi agreed to take the first \$29 billion loss on the pool.) Goldman Sachs and Morgan Stanley would morph from investment banks into bank holding companies regulated by the FDIC, the same agency that monitors commercial banks. Wall Street would never be the same.

Many of the principal actors in the drama of the September weekend have been transformed as well. The Lehman crowd is no longer who they used to be. Bryan Marsal, a noted turnaround expert, has replaced Fuld as CEO of Lehman Brothers Holdings, and is busy liquidating the remaining assets of the firm. Fuld has been moved out of his palatial office to more modest digs on the 45th floor of the Time & Life Building, which houses Fortune as well. He was spotted entering that building recently wearing a tuxedo. A security guard stopped him on his way through the lobby and said "Huh? What's that name again?"

No one is crying for him. In addition to some world-class real estate in Manhattan, Greenwich, Connecticut, Sun Valley, Idaho and Jupiter Island, Florida, Fuld probably has around \$100 million in the bank, including \$20 million just received from selling a portion of his and his wife's art collection. He's reportedly also considering opening his own advisory boutique.

In addition to the \$639,082 Fuld received for selling 2.87 million shares for twenty cents each on September 17 (he still has another 503,744 shares that are now worthless), he also has a grand jury subpoena from three U.S. attorney's offices in the Eastern and Southern districts of New York, and in the district of New Jersey, which are investigating whether Lehman executives made false or misleading statements about the firm leading up to its collapse.

Thain has agreed to stay on at the combined Bank of America/Merrill after the deal closes in a few weeks. He will continue to oversee the Merrill Lynch businesses at Bank of America and report directly to Lewis. He will no doubt have a large role in helping to eliminate 35,000 jobs - as has been announced - at his new firm. His triumph of that weekend has been tainted, in part, by the fact that the fall in Bank of America's stock since September 15 has reduced the value of the deal to Merrill's stockholders to around \$20 billion, from \$50 billion. Still, that is better than the zero dollars received by Lehman's shareholders. Thain also misjudged the zeitgeist by asking for a \$10 million bonus this year from the Merrill board and had to quickly retreat in the face of negative publicity and the outrage of many, including Andrew Cuomo, New York's attorney general.

Geithner emerged from the weekend in the best shape of all. Puffs of smoke emanating from the palazzo suggested in the aftermath of the calamity that he was more inclined than his brethren to try to find a government solution for Lehman Brothers. In any event, he seems to have passed his six-month trial by fire and is awaiting his

confirmation hearing to become secretary of the Treasury in the Obama administration.

When Bernanke and Paulson have discussed their decision to let Lehman fail, neither one has any doubts about the wisdom of their decision. "A public-sector solution for Lehman proved infeasible," Bernanke said at the Economic Club of New York on October 15, "as the firm could not post sufficient collateral to provide reasonable assurance that a loan from the Federal Reserve would be repaid, and the Treasury did not have the authority to absorb billions of dollars of expected losses to facilitate Lehman's acquisition by another firm. Consequently, little could be done except to attempt to ameliorate the effects of Lehman's failure on the financial system."

On Monday morning, September 15, as the Lehman volcano was spewing molten financial lava to every corner of the globe, a pale and tired-looking Paulson - whose brother worked for Lehman, in Chicago - said at a White House press conference that he "never once considered that it was appropriate putting taxpayer money on the line in resolving Lehman Brothers." He added, "Moral hazard is not something I take lightly."

-William D. Cohan is the author of "The Last Tycoons: The Secret History of Lazard Freres" and the soon-to-be-published "House of Cards: A Tale of Hubris and Wretched Excess on Wall Street" ■

First Published: December 15, 2008: 12:34 AM ET

Find this article at:

http://money.cnn.com/2008/12/12/magazines/fortune/3days_full.fortune

☐ Check the box to include the list of links referenced in the article.

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TAB 56

Tobias Adrian/NY/FRS
09/13/2008 08:40 PM

To Adam Ashcraft/NY/FRS@FRS, Alejandro
LaTorre/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS,
Beverly Hirtle/NY/FRS@FRS, Brian Peters/NY/FRS@FRS,
cc

bcc

Subject AIG's Financial System Risk

Here is the systemic risk analysis from market prices. Note that this is only the financial system risk captured in current market prices, so it should be viewed as a lower bound.



AIG Financial System Risk Evaluation.pdf

Tobias Adrian
Federal Reserve Bank of New York
Capital Markets Research
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The views in this message are those of the sender and not necessarily those of the Federal Reserve Bank of New York or the Federal Reserve System.

AIG's Financial System Risk¹

Intro:

By lending to AIG, the Fed will further extend the universe of institutions with discount window access, thus changing expectations about future Fed behavior. This note discusses some of the pros and cons.

The case for lending to AIG:

Fed wants to limit the systemic risk externalities, and the potential spillover onto the real economy (the "Adverse Feedback Loop"). Estimates of systemic risk losses are potentially large. The quantitative assessment of financial system spillovers is in the Figures starting on page 3. Note that these might be underestimates, as systemic risk events of the current magnitude are not in the historical data.

Figure 1: This figure plots the default probabilities implied by the CDS spreads of AIG, Lehman Brothers, and the primary dealer universe (PD). Implied default probabilities of both AIG and Lehman have been rising rapidly in recent weeks. The default probability of AIG is lower than Lehman's, but has risen more rapidly in recent days.

Figure 2: This plot is a measure of risk spillover from AIG to the PDs, from Lehman to the PDs, and the average spillover risk for the whole PD universe. The spillover risk is computed from CDS returns, and converted into a default probability.² The probability of default in Figure 2 is the additional likelihood of defaulting due to risk spillovers (i.e. systemic risk). The Figure shows that the systemic risk of AIG relative to the PD universe is smaller than the systemic risk of Lehman. Caveat: these results are not value weighted.

Figure 3: Plot of the VaR and CoVaR of the investment bank universe. The difference between VaR and CoVaR is a measure of financial system risk. The difference between CoVaR and VaR measures the increase in VaR due to exposure to the financial sector. In this figure, the financial sector is proxied by the S&P financials sub index, and the CoVaR and VaR is in percent, for equity returns (more negative numbers correspond to larger risk).

Figure 4: Figure 4 shows that in equity space, the CoVaR is, on average, smaller than the VaR, implying that the tail covariance of AIG with the financial sector is negative. So, based on historical data, AIG is not systemically important. The caveat here is that current equity prices might not fully price adverse feedback loop dynamics.

¹ Prepared by Tobias Adrian, ext 1717, with comments by Josh Frost.

² The measure is based on http://newyorkfed.org/research/staff_reports/sr348.html.

The case against lending to AIG:

1. AIG could fix its problem by selling its mortgage portfolio. This might lead to further declines in mortgage valuations in the market place, but the institutions that we judge systemically important all have discount window access (either DW or PDCF).
2. Discount window borrowing might increase the likelihood of AIG's default as it reveals to the market that AIG is in worse shape than previously assumed.
3. Fed sends signal to the market that the market fragility is greater than currently priced in.
4. By lending to AIG, Fed signals that existing universe of facilities is not enough to assure financial stability.
5. Fed's lending will change the behavior of other insurance companies (and the lenders to other insurance companies), who will assume that they will get similar loans in future situations.
6. Fed's hands are tied for future situations.
7. The Fed crowds out private market solutions, and distorts price discovery.
8. Future backlash against Fed powers (as Fed will be seen as captured by Wall St.).
9. Every dollar that Fed lends to AIG is a dollar that cannot be used for other purposes: the Fed's balance sheet constraints might be binding at some point.
10. Treasury will have to issue more debt to allow Fed to lend to AIG in size. That has adverse effects on inflation, capital flows, and US credit ratings.

Alternatives to lending to AIG:

1. Lend to the counterparties of the CB and PD universe who already have discount window access.
2. Have Treasury or NY State, not Fed make a loan to AIG.

Figure 1: CDS implied Default Probabilities

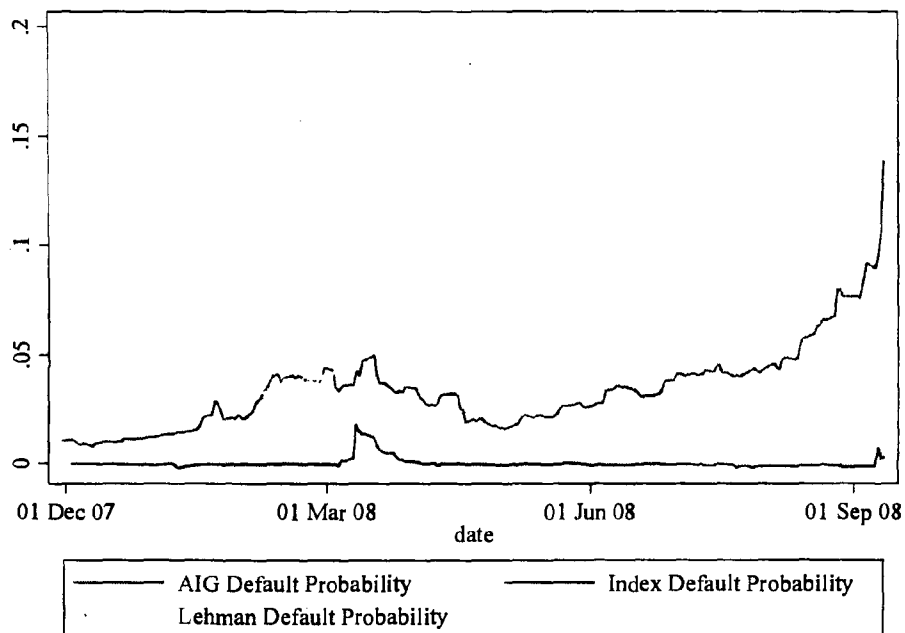


Figure 2: Systemic Risk Default Probability Spillover Component (from CDS)

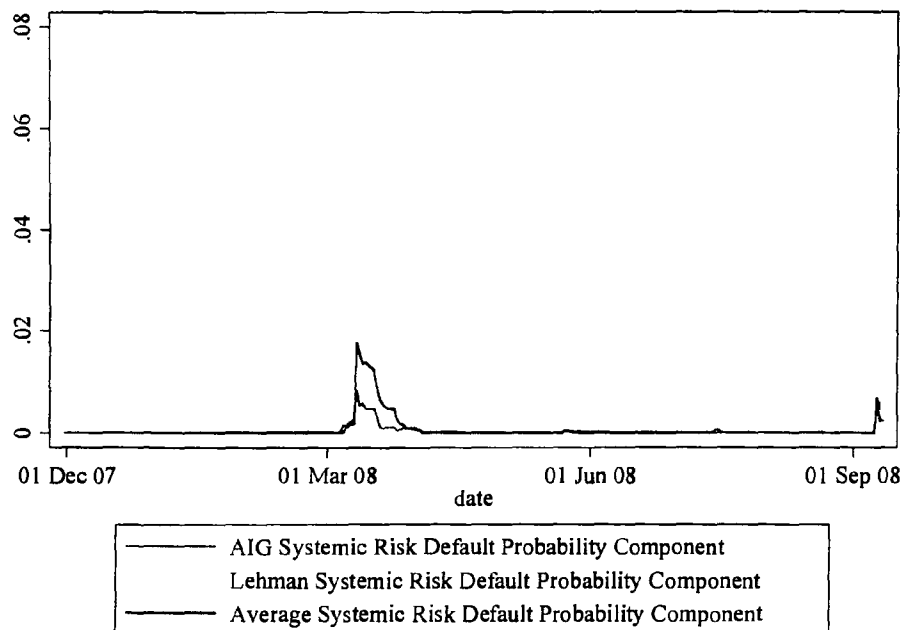


Figure 3: VaR and CoVaR of Investment Bank Equity Returns

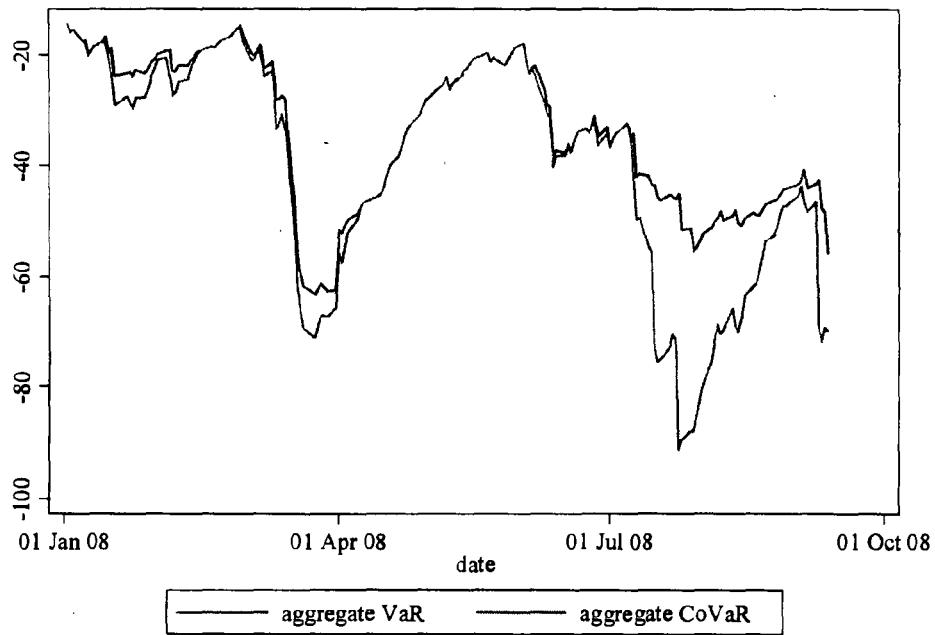
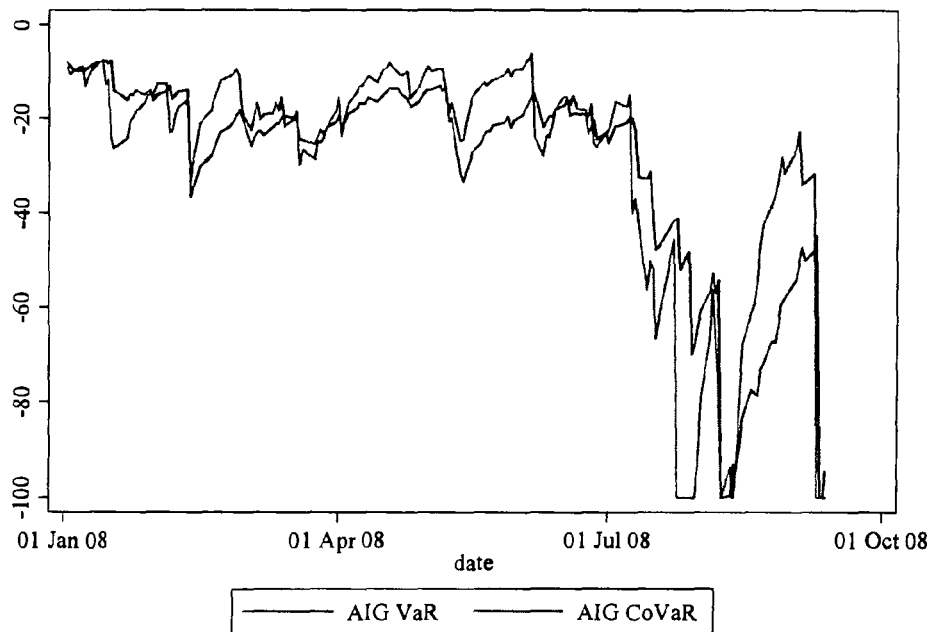


Figure 4: VaR and CoVaR of AIG Equity Returns



TAB 57

From: [Jeff Stehm](#)
To: [Deborah P Bailey](#)
Subject: Fw: Master timeline as of 9/13 11:30am
Date: 09/13/2008 02:45 PM
Attachments: [Lehman 9.13.08 1130am EU.xls](#)

See below. From NY. with your name attached :)

Jeff Stehm
Associate Director
Federal Reserve Board

----- Forwarded by Jeff Stehm/BOARD/FRS on 09/13/2008 02:44 PM -----

**Erin
Upton/NY/FRS@FRS**

09/13/2008 11:29 AM

To brehenyb@sec.gov, canavanj@sec.gov, Clinton Lively/NY/FRS@FRS, Dianne Dobbeck/NY/FRS@FRS, hsum@sec.gov, Jan Voigts/NY/FRS@FRS, Jeanmarie Davis/NY/FRS@FRS, Jeff Stehm/BOARD/FRS@BOARD, Jeffrey Marquardt/BOARD/FRS@BOARD, Jim Mahoney/NY/FRS@FRS, JohnP McGowan/NY/FRS@FRS, Jonathan Polk/NY/FRS@FRS, Joseph Sommer/NY/FRS@FRS, Lily Tham/NY/FRS@FRS, Lisa Joniaux/NY/FRS@FRS, Lucinda M Brickler/NY/FRS@FRS, Marsha Takagi/NY/FRS@FRS, mcgowant@sec.gov, Michael Schussler/NY/FRS@FRS, Patrick M Parkinson/BOARD/FRS@BOARD, Shari Ben-Haim/NY/FRS@FRS, Susan Stiehm/NY/FRS@FRS, Theodore Lubke/NY/FRS@FRS, Wendy Ng/NY/FRS@FRS, Ada Li/NY/FRS@FRS, Jamie McAndrews/NY/FRS@FRS, Chris McCurdy/NY/FRS@NY, Theodore Lubke/NY/FRS@FRS, Alexandra Merle-Huet/NY/FRS@FRS, Daniel Muccia/NY/FRS@FRS, Roger Graham/NY/FRS@FRS, Lawrence Sweet/NY/FRS@FRS

cc Ann Miner/NY/FRS@FRS, Erin Upton/NY/FRS@FRS

Subject Master timeline as of 9/13 11:30am

Attached is the master timeline for Saturday/Sunday/Monday scheduled meetings. A snapshot view of this afternoons meetings is shown directly below as well. Please keep us updated as to any additional meetings you schedule.

Sat Sept 13		
12PM Noon	Fed: Official-Organized Consortium	Official sector updated on progress
12PM Noon	Default Management Group/Operations Management Group	FR may ask private sector to activate Operations Managers Group
12:30PM	Fed	Treasury, CFTC, SEC, Fed Call
1PM	Fed	LFIT and LFI CPC Call
2PM	Lehman	Potential Bankruptcy Court Notification
2PM	Fed	CLS Supervisory Call
2:30PM	Fed	DTC - Settlements (Securities)
2:30PM	AIG Meeting	Bill Rutledge
After 4PM	Fed	OTS - Federal Thrift (Deborah Bailey)
6PM	Fed: Official-Organized Consortium	Official sector updated on progress
10PM	Fed: Official-Organized Consortium	Official sector updated on progress



Lehman 9.13.08 1130am EU.xls

Erin Upton
Federal Reserve Bank of New York
(212) 789-4444

**Master Timeline
as of Saturday 9/13 11:15AM**

Sat Sept 13		
12PM Noon	Fed: Official-Organized Consortium	Official sector updated on progress
12PM Noon	Default Management Group/Operations Management Group	FR may ask private sector to activate Operations Managers Group
12:30PM	Fed	Treasury, CFTC, SEC, Fed Call
1PM	Fed	LFIT and LFI CPC Call
2PM	Lehman	Potential Bankruptcy Court Notification
2PM	Fed	CLS Supervisory Call
2:30PM	Fed	DTC - Settlements (Securities)
2:30PM	Meeting	Bill Rutledge
After 4PM	Fed	OTS - Federal Thrift (Deborah Bailey)
6PM	Fed: Official-Organized Consortium	Official sector updated on progress
10PM	Fed: Official-Organized Consortium	Official sector updated on progress

Sun Sept 14

<u>Time</u>	<u>Who</u>	<u>Activity</u>
7:45AM	Markets	Tokyo International Financial Futures Exchange Opens for Monday*
9AM	Fed	Foreign Supervisors Call to coalition participants
10AM	Fed	Domestic Supervisors Call
10AM	Market (NYMEX)	Energy markets open early for trading (Hurricane)
12PM	Fed: Official-Organized Consortium	Effective deadline for credible plan FRBNY updates relevant US, foreign regulators and other relevant officials.
3:30PM	Fed	CLS Supervisory Call
4PM	Citi - CLS	Period for Citi to decide to authorize Lehman settlement instructions to CLS.
Early Evening	Fed: Official-Organized Consortium	Deadline for public announcement if this plan materializes.
6:25PM	Markets	USFE Opens
8PM	Markets	Japanese Securities Depository Centre Opens* Australia Securities Exchange Opens Tokyo Stock Exchange Opens*
8PM	Payments	Bank of Japan Funds Transfer System Opens*
9PM	Fed	Fedwire Funds Open 9PM for next-day business activity. Lehman can begin sending cash wires through JPMC to its DTC account (at FRBNY).
9:30PM	Markets	Hong Kong Exchange Opens*

Please note that for weekend work, DTC closes on Friday and CLS opens Sunday.

* Monday, September 15 is a Holiday and these markets will be closed.

Mon Sept 15

**Master Timeline
as of Saturday 9/13 11:15AM**

<u>Time</u>	<u>Who</u>	<u>Activity</u>
12:30AM	CLS	Revised pay-in schedule issued 12:30AM
12:30AM	CLS	Bilateral rescinds at 12:30AM
12:30AM	CLS	Settlement eligible instructions transferred.
3AM	CLS	Completion of settlement
3AM	Markets	London International Financial Futures and Options Exchange - Opens - Europe and London
3AM	Markets	London Stock Exchange Opens
4AM	CLS	CLS pays in and out Asia/Pac by 4AM
4AM	Markets	Japanese Securities Depository Centre Closes*
6AM	CLS	CLS and N. America pays in and out by 6AM
Start of Day	DTC	Government Securities Division (GSDs), General Collateral Finance (GCF), Repo unwinds
Start of Day	DTC	GSDs, GSF, Repo Unwinds
7AM	Markets	Tokyo International Financial Futures Exchange*
7:40AM	Market (CME)	Lehman settlement bank confirms daily variation and PB payment
8AM	Fed	Lehman can begin flowing securities through JPMC to its DTC account (at FRBNY)
8AM	Tri-Party	Does the clearing bank unwind repo transactions prior day? Fed should expect call by 8AM
8:30AM	Tri-Party	Are investors fleeing from Lehman? Should be able to gauge by 8:30AM. Their clearing banks would start seeing parties step away.
8:30AM	OCC	Clearing members make net premium and variation payments to OCC. Margin payments are generally made at the same time.
9:30AM	FICC	Clearing Fund Requirements for FICC due. FICC settles through Fed NSS. NSCC settles through Fedwires to DTC.
10AM	Market (NYMEX)	Lehman settlement bank confirms daily variation and PB payment
10AM	NSCC	Clearing Fund Requirements for NSCC due. NSCC settles through Fedwires to DTC Fed Account.
FICC by 9:30AM NSCC by 10AM	DTC	Clearing Fund Requirements due.
9:30AM	Markets	NASDAQ, CBOE and NYSE Open
11:40AM	Market (NYMEX)	Daily PB and intra-day variation information provided to Lehman
1PM	Market (NYMEX)	Lehman settlement bank confirms daily PB and intra-day variation
2PM	MBSD	Deadline for clearing fund requirements.
2PM	Market (CME)	Intra-day PB and variation information provided to Lehman
2:40PM	Market (CME)	Lehman settlement bank confirms intra-day PB and variation information
3PM	DTC	Issue and paying agent (IPA) cutoff for informing DTC of an issuer failure/default within the money market instrument market (MMI). Citi is Lehman's IPA.
3:30PM	DTC	Participants have until 3:30PM to DK ("don't know") transactions
3:45PM	DTC	Lehman's settlement bank (JPMC) confirms end-of-day DTC numbers.
4PM	DTC	Obligations for GSD are being made up until this point.
4PM	Markets	NASDAQ and NYSE Close
Throughout the day	Tri-Party	Sec Lending: Are owners reluctant to lend?
4:30	DTC	Completion of DTC, NSCC and Canadian settlement
4PM	Citi-CLS	Citi to decide authorization on Lehman transactions.
6PM	CLS	Initial pay-in schedule is issued.
6PM	Fed	Fedwire 3rd party close
6:30PM	Fed	Fedwire Settlement
* Monday, September 15 is a Holiday and these markets will be closed.		

TAB 58

From: Bernanke
To: [Scott Alvarez](#)
Subject: Re: Fw: Scheduled Call today at 7:00 p.m. w/Chairman Bernanke, Vice Chairman Kohn and Others
Date: 09/13/2008 04:08 PM

Thanks.

I am leaving soon and will take the call from home.

Sent from my BlackBerry Wireless Handheld

▼ [Scott Alvarez](#)

----- Original Message -----

From: Scott Alvarez
Sent: 04:06 PM EDT
To: Bernanke
Cc: Bernanke Kevin Warsh; Michelle Smith
Subject: Re: Fw: today at 7:00 p.m. w/Chairman Bernanke,
Vice Chairman Kohn and Others

That will work. To make it easier, Randy and Betsy can take a cue from Tim, who it sounds like will make a pitch for legislation. That sounds like the part of the call that would be most susceptible to a policy discussion, rather than just a briefing on the day's developments. I would be happy to call Randy and Betsy after the call and fill them in. We can then have a policy discussion at a Board meeting at an appropriate later time.

Scott

▼ Bernanke [BOARD/FRS](#)

Bernan

ke **BOARD/FRS**

09/13/2008 02:31 PM

To: Scott Alvarez/BOARD/FRS@BOARD
cc: Bernanke BOARD/FRS@BOARD, Kevin Warsh/BOARD/FRS@BOARD, Michelle A Smith/BOARD/FRS@BOARD, Donald L Kohn/BOARD/FRS@BOARD
Subject: Fw: Scheduled Call today at 7:00 p.m. w/Chairman Bernanke, Vice Chairman Kohn and Others

Scott: I invited Randy and Betsy to listen in on this call. However, I have learned that we may want to discuss some broader issues, e.g., should we go to Congress to ask for other authorities. We can't discuss policy issues with more than 3 Board members. So I called Randy and Betsy and told them they could hear the briefing/update on Lehman, with which we should begin the call. But if it turns to policy, they should hang up. They were both totally fine with that. (You could enforce that if you are on the call.) Let me know if you see any problem.


Ben

----- Forwarded by Bernanke BOARD/FRS on 09/13/2008 02:28 PM -----

**Randall S
Kroszner/BOARD/FRS**

To Bernanke BOARD/FRS@BOARD
cc

09/13/2008 01:09 PM

Subject Re: Fw: Scheduled Call today at 7:00 p.m.
w/Chairman Bernanke, Vice Chairman Kohn and
Others 

▼ Bernanke Thanks. I will plan to call in.
BOARD/FRS

Bernan
ke **BOARD/FRS**

To Randall S Kroszner/BOARD/FRS@BOARD, Elizabeth A
Duke/BOARD/FRS@BOARD

cc Donald L Kohn/BOARD/FRS@BOARD

09/13/2008 12:58 PM

Subject Fw: Scheduled Call today at 7:00 p.m. w/Chairman
Bernanke, Vice Chairman Kohn and Others

Randy, Betsy:

Below is info for conference call with NY at 7 pm. I would probably
take that at home rather than at the office. You are welcome to listen
in.

As far as I know there is no formal conference call scheduled before
then. If I get substantive new information I will let you know.

----- Forwarded by Bernanke BOARD/FRS on 09/13/2008 12:55 PM -----

**Rita C
Proctor/BOARD/FRS**

To Bernanke BOARD/FRS
cc

09/13/2008 12:50 PM

Subject Fw: Scheduled Call today at 7:00 p.m. w/Chairman
Bernanke, Vice Chairman Kohn and Others

Are you planning to participate?

Rita

Rita C. Proctor

Assistant to the Chairman
The Honorable Ben S. Bernanke
Federal Reserve Board
Eccles Board Building
20th and C Street, N.W.
Washington, DC 20551
Phone: 202-452-3201
Fax: 202-452-6499
rita.c.proctor@frb.gov

▼ Marlene Williams

----- Original Message -----

From: Marlene Williams
Sent: 09/13/2008 12:48 PM EDT
To: Rita Proctor; Rivane Bowden; Brian Madigan; Patrick Parkinson; Michelle Smith; Thomas Baxter; Terrence Checki; William Dudley; Meg McConnell; Calvin Mitchell; Michael Silva; Donald Kohn
Cc: Tanshel Pointer; Daniel Boulos; Helen Ayala; Helen Wendler; Millie Martinez
Subject: Scheduled Call today at 7:00 p.m. w/Chairman Bernanke, Vice Chairman Kohn and Others
Please be advised that there will be a call this evening at 7:00 p.m. as indicated below. Please confirm your (or your boss's) participation.
Thank you.

Participants

Board

Chairman Bernanke
Vice Chairman Kohn
Brian Madigan
Pat Parkinson
Michele Smith
FRBNY
Tom Baxter
Terry Checki
Bill Dudley
Meg McConnell
Calvin Mitchell
Michael Silva

Marlene A. Williams
Executive Assistant to the President
Federal Reserve Bank of New York
33 Liberty Street
New York, NY
(Office) 212-720-6174
(Fax) 212-720-8681

TAB 59

From: [Michelle A Smith](#)
To: [Kevin Warsh](#)
Subject: Fw: Newsclips on today's meeting (2:30 PM)
Date: 09/13/2008 02:35 PM

A deal doesn't seem likely tonight, right?

▼ [David M Girardin](#)

----- Original Message -----

From: David M Girardin
Sent: 09/13/2008 02:34 PM EDT
To: Calvin Mitchell; Andrew Williams; Michelle Smith; David Skidmore; Michael Silva; Michael Held; Meg McConnell
Cc: Krista Dente
Subject: Newsclips on today's meeting (2:30 PM)

- Wall Street Journal - Lehman Deal Could Come Tonight As High-Level Talks Continue
- Reuters - Fed holds emergency meeting on market developments
- AP - Government, brokerage leaders resume meeting on plan to rescue Lehman Brothers
- Bloomberg -Treasury, Fed Summon Wall Street Leaders for Second Day Talks

WALL STREET JOURNAL - Lehman Deal Could Come Tonight As High-Level Talks Continue

By CARRICK MOLLENKAMP, DEBORAH SOLOMON, AARON LUCCHETTI, JON HILSENATH and SUDEEP REDDY

Talks continued Saturday between federal officials and top Wall Street executives aimed at resolving the crisis swirling around Lehman Brothers Holdings Inc. and soothing jittery U.S. financial markets.

While the situation remains fluid, some sort of solution might be reached as soon as Saturday night, according to people familiar with the situation. But it isn't clear how much progress has been made toward clearing the biggest hurdle in the discussions, which is whether any government funding will be provided to help engineer a rescue for the battered investment bank.

Treasury Department and Federal Reserve officials have made it clear to participants that no government bailout should be expected. Potential bidders, worried about the risk of buying an ailing financial institution like Lehman, want the government to step in with a package similar to what was offered to J.P. Morgan when it bought Bear Stearns Cos. Then, the federal government agreed to absorb as much as \$29 billion in losses.

On Saturday, the main task ahead in discussions being led by the Federal Reserve is identifying whether a so-called "bad bank" structure could be designed to hold Lehman's souring assets. That issue is now seen by people familiar with the situation as the key stumbling block to completing a deal, especially if Treasury and Fed officials keep digging in their heels on opposition to a government-backed rescue.

Potential buyers such as Bank of America Corp. and Barclays PLC are loathe to take on Lehman's bad assets, which are seen as an immovable object to getting a deal done, according to people familiar with the situation.

At an emergency meeting Friday night called by the Federal Reserve Bank of New York, New York Fed President Timothy Geithner, described two potential scenarios: either a liquidation of Lehman or an industry-driven solution in which Wall Street firms would possibly providing financing to remove some of Lehman's real estate assets, one person briefed on the matter said.

Most of the Wall Street executives present at the meeting listened and asked questions, "but didn't show their hands" as to what they thought, this person said.

In addition to Mr. Geithner, government officials in attendance included Treasury Secretary Henry Paulson and Securities and Exchange Commission Chairman Christopher Cox. The Wall Street executives included Morgan Stanley Chief Executive John Mack, Merrill Lynch Chief Executive John Thain, J.P. Morgan Chase CEO Jamie Dimon, Goldman Sachs Group CEO Lloyd Blankfein, Citigroup Inc. head Vikram Pandit and representatives from the Royal Bank of Scotland Group PLC and Bank of New York Mellon Corp.

Other industry leaders that attended were Credit Suisse CEO Brady Dougan, Morgan Stanley Chief Financial Officer Colm Kelleher, Citigroup Chief Financial Officer Gary Crittenden, UBS AG Chief Risk Officer Thomas Daula, J.P. Morgan investment bank co-head Steve Black and Goldman Sachs Co-president Gary Cohn, according to a person familiar with the matter.

At the New York Fed's fortress-like stone and iron headquarters in lower Manhattan, Mr. Black and Steve Cutler, J.P. Morgan's general counsel, left the building early Saturday afternoon in a black sedan.

Mr. Cutler was carrying a manila envelope thick with papers. He exited through the heavily guarded garage entrance at the corner of William Street and Maiden Lane, declining to comment on the talks.

The meeting appeared similar to one a decade ago when the New York Fed pulled together top Wall Street executives to prevent the collapse of hedge fund Long-Term Capital Management.

In all, about 30 banks were represented at the meeting, which also included an assessment of the risk Lehman's trading partners and other counterparties face and discussion of Merrill Lynch and Washington Mutual Inc., which saw their stock prices slide in recent days on growing fears about their financial condition.

In trying to hold firm to their no-bailout stance even while pressing for a deal, federal officials could try to pit Bank of America and Barclays

against each other. But that leverage can work only if both banks stay in the discussions.

Bank of America and Barclays know each other very well, having considered a merger several years ago. More recently, Bank of America agreed to pay \$21 billion for ABN Amro Holding NV's LaSalle Bank of Chicago in 2007. That deal came at a time when Barclays was trying to buy ABN and fend off a European consortium bid. Bank of America's purchase was seen at the time as helping that Barclays bid, which ultimately failed.

At Barclays, a big question will be whether President Robert E. Diamond Jr. and CEO John Varley both agree on buying all or part of Lehman. Mr. Diamond is eager to expand Barclays's U.S. investment bank operations. But the unit, called Barclays Capital, is also responsible for write-downs the bank has recorded.

After orchestrating the rescue of Bear and advising on the shift of Fannie Mae and Freddie Mac into government conservatorship, Federal Reserve officials would very much like to draw a line with Lehman and avoid any involvement that goes beyond the role officials have played in advising Lehman to help it resolve its problems.

After Bear's collapse, the Fed set up lending facilities to help investment banks with short-term liquidity needs. As of Wednesday, it hadn't been tapped by Wall Street since July. The mere presence of the lending program – called the primary dealer credit facility – might be helping to reassure market participants that Lehman is a reliable counterparty, since they know it has access to the facility should it need it. It isn't clear whether the Fed would be willing to extend its lending facilities even further for anything beyond helping a firm manage a short-term liquidity crisis.

"The financing that we did for Bear Stearns is a one-time event that has never happened before, and I hope it never happens again," Fed Chairman Ben Bernanke told lawmakers in April.

"As far as I know, we've never lost a cent. So it is not our intention on anything like a regular basis to be putting taxpayer money at risk."

Mr. Bernanke also has expressed reservations about lending to troubled institutions. "The intended purpose of Federal Reserve lending is to provide liquidity to sound institutions," he said in a July 8 speech. The Fed used its lending powers to help Bear in March "only because no other tools were available to the Federal Reserve or any other government body for ensuring an orderly liquidation in a fragile market environment."

Paramount to Fed officials is the broader health of the financial system. Behind the rescue of Bear was a fear that its collapse would disrupt already shaky credit markets.

Conditions now are mixed. Short-term lending rates such as the

London Interbank Offered Rate, or Libor, are elevated relative to expectations for the Fed's benchmark fed funds rate, a sign of pervasive risk aversion, but have been stable. Risk premiums on junk bonds also are back to levels they hit in March. But the broader stock market has been relatively stable through this latest round of turmoil.

One constraint for federal officials is that many of the steps they hoped to have taken to resolve another investment bank crisis have not yet been taken. Investment banks are big players in the credit default swap market, in which firms trade contracts tied to corporate default risks. It's an immense market that trades against \$62 trillion worth of debt. Officials worry that the collapse of an investment bank could send problems cascading through the financial system through this market. They've been pushing Wall Street to create a new clearinghouse to diminish that risk, but it isn't in place yet.

They've also want Congress to develop new procedures to handle the collapse of an investment bank so that it can be closed by the government in an orderly way, as happens with failed commercial banks. That also is far from completion.

Write to Carrick Mollenkamp at carrick.mollenkamp@wsj.com¹, Deborah Solomon at deborah.solomon@wsj.com² and Aaron Lucchetti at aaron.lucchetti@wsj.com³

Reuters - Fed holds emergency meeting on market developments

232 words
12 September 2008
22:03
Reuters News
English
(c) 2008 Reuters Limited

(Adds participants, paragraph 3; additional background, paragraph 4)

WASHINGTON, Sept 12 (Reuters) - The **Federal Reserve** Bank of New York held an emergency meeting on Friday evening with top financial market representatives to discuss recent market developments, a Fed official said.

"Senior representatives of major financial markets met at the **Federal Reserve** Bank of New York Friday evening to discuss recent market developments," a Fed official told Reuters.

The official said New York Fed President Timothy Geithner, U.S. Treasury Secretary Henry Paulson and Securities and Exchange Commission Chairman Christopher Cox were among the participants in the meeting.

Financial markets have been on tenterhooks over the future of **Lehman** Brothers Holdings Inc and whether the struggling investment bank, whose stock value has collapsed, may or may not be able to find a buyer. The talks at the New York Fed took place as discussions between **Lehman** and other parties continued.

The Treasury and Fed have been involved in talks regarding **Lehman's** future. Earlier on Friday, a source familiar with the thinking of Treasury Secretary Henry Paulson said Paulson was "adamant" no public funds be put on the line to help facilitate a sale. (Reporting by Glenn Somerville; Writing by Tim Ahmann; Editing by Gary Hill)

AP - Government, brokerage leaders resume meeting on plan to rescue Lehman Brothers

By JEANNINE AVERSA

AP Economics Writer

125 words

13 September 2008

12:50

Associated Press Newswires

English

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WASHINGTON (AP) - With the global financial system holding its collective breath, the U.S. government is scrambling to help devise a rescue for Lehman Brothers and restore confidence in Wall Street and the American financial structure.

An official from the Federal Reserve Bank of New York said Saturday deliberations have resumed with leading Wall Street executives and top U.S. financial officials. They include Treasury Secretary Henry Paulson, Timothy Geithner, president of the New York Fed, and Securities and Exchange Commission Chairman Christopher Cox. They were meeting on the heels of an emergency session convened Friday night by Geithner -- the Fed's point person on financial crises.

BLOOMBERG -Treasury, Fed Summon Wall Street Leaders for Second Day Talks

2008-09-13 17:37:17.820 GMT

By Yalman Onaran

Sept. 13 (Bloomberg) -- The U.S. Treasury and the Federal Reserve Bank summoned chief executive officers of Wall Street firms for a second day of talks to find a solution to the plight of Lehman Brothers Holdings Inc.

Treasury Secretary Henry Paulson and New York Fed President Timothy Geithner met with executives in New York, said Andrew Williams, a spokesman for Geithner.

--With reporting by Chris Anstey in Washington. Editor: Dick Schumacher.

TAB 60

[REDACTED]

From: Stephen P. Harbeck [REDACTED]
Sent: Saturday, September 13, 2008 5:55 PM
To: Nason, David
Subject: RE: Lehman Brothers

David:

Herewith a bunch of my telephone contacts:

Office direct dial to my desk: [REDACTED]

Cell: [REDACTED]

Home: [REDACTED]

To give you an update from our perspective, we are in the process of completing the drafting of legal papers, and we will be available to get the papers filed tomorrow, if that is necessary. The SEC prefers a self-liquidation without a bankruptcy filing. SEC staff may try to prevent such a bankruptcy filing by noting that the very filing gives SIPC grounds to take over. Of course, even if Lehman does make a Chapter 7 filing we would only go in if the SEC stated that to be preferable.
Steve

From: David.Nason@do.treas.gov [mailto:David.Nason@do.treas.gov]
Sent: Saturday, September 13, 2008 5:49 PM
To: Stephen P. Harbeck
Subject: Re: Lehman Brothers

Steve -

Pls send me numbers where you will be reachable if needed. I am not in new york but the Secretary and others are there and I want them to have the ability to reach u if needed. No one has asked me, but just thinking ahead. Thx.

David:

From: Stephen P. Harbeck
To: bucelo [REDACTED]; todd.farha [REDACTED]; Heyman, William H; William Jasien [REDACTED]; Nason, David; mark.shelton [REDACTED]; Dave.Stockton [REDACTED]
Cc: Philip W. Carduck; Josephine Wang; Hughes, Gerry; Hunt, Betty Ann; Julie.Edwards [REDACTED]
Sent: Sat Sep 13 15:29:40 2008
Subject: Lehman Brothers
Members of the Board:

At the request of the Division of Market Regulation of the SEC, SIPC will prepare pleadings this evening to initiate a SIPA case against Lehman Brothers. The SEC still prefers a "self-liquidation", but the current thinking is that the firm may, against the desires of the SEC staff, file a Chapter 7 liquidation as early as Sunday. Pursuant to SIPC's Bylaws, Chairman Bucelo has authorized a SIPA filing if it becomes necessary.

For technical reasons, a brokerage firm may only use Subchapter III of Chapter 7. SIPC and the SEC may take the position that such a filing is damaging to customers, because that Subchapter requires the liquidation of all securities positions. SIPA, on the other hand, requires the delivery of the securities positions wherever practicable.

The situation is both very fluid and very "non-public". Should it become necessary to take action, Jim Giddens of Hughes Hubbard and Reed will serve as trustee and counsel.

TAB 61

From: [Scott Alvarez](#)
To: [Mark VanDerWeide](#)
Subject: Re: tri-party
Date: 09/13/2008 07:44 PM

Not if it's the only question about how to manage the bankruptcy--don't want to suggest Fed willingness to give JPMC cover to screw L or anyone else.


Scott

▼ [Mark VanDerWeide/BOARD/FRS](#)

**Mark
VanDerWeide/BOARD/FRS**

To Scott Alvarez/BOARD/FRS@BOARD
cc

09/13/2008 07:41 PM

Subject Re: tri-party 

We have no idea. FRBNY set it up. If the call is about lots of stuff, are you OK with this being one topic?


Mark

▼ [Scott Alvarez/BOARD/FRS](#)

**Scott
Alvarez/BOARD/FRS**

To Mark VanDerWeide/BOARD/FRS@BOARD
cc

09/13/2008 07:41 PM

Subject Re: tri-party 

What is the context of the JPMC call? Are we asking other similar questions?
Scott

▼ [Mark VanDerWeide/BOARD/FRS](#)

**Mark
VanDerWeide/BOARD/FRS**

To Scott Alvarez/BOARD/FRS@BOARD
cc

09/13/2008 07:39 PM

Subject tri-party

Are you OK with us running the tri-party solution structure we spoke with you about

just now past JPMC to see if it is operationally feasible for them (acknowledging that this is just one of many options that are kicking around). FRBNY legal and policy thinks our proposal is workable and the best option we have right now. JPMC call is starting shortly.

Mark

TAB 62

From: [Arthur Angulo](#)
To: [Thomas Baxter](#); [Joyce Hansen](#); [Jonathan Polk](#); [Chris McCurdy](#); [Patrick M Parkinson](#); [Gerard Dages](#); [Joseph Sommer](#)
Cc: [Theodore Lubke](#)
Subject: Fw: memo re: Lehman's inter-company default scenario
Date: 09/13/2008 08:24 PM
Attachments: [leh-def-scenario-memo-20080913.doc](#)
[FundingFacilities.xls](#)

haven't opened docs yet ...

----- Forwarded by Arthur Angulo/NY/FRS on 09/13/2008 08:19 PM -----

**Christopher T
Tsuboi/NY/FRS**

09/13/2008 08:01 PM

To Alejandro LaTorre/NY/FRS@FRS, Alexa Philo/NY/FRS@FRS, Anthony Cirillo/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Bard Stermasi/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Caroline Frawley/NY/FRS@FRS, Catherine Voigts/NY/FRS@FRS, Christopher Calabia/NY/FRS@FRS, Clinton Lively/NY/FRS@FRS, Daniel Muccia/NY/FRS@FRS, Dennis Herbst/NY/FRS@FRS, Dianne Dobbeck/NY/FRS@FRS, Jan Voigts/NY/FRS@FRS, Jeanmarie Davis/NY/FRS@FRS, Jim Mahoney/NY/FRS@FRS, John Ricketti/NY/FRS@FRS, Jonathan Polk/NY/FRS@FRS, Kyle Grieser/NY/FRS@FRS, Lily Tham/NY/FRS@FRS, Paul Whynott/NY/FRS@FRS, Robert Galletta/NY/FRS@FRS, Roger Graham/NY/FRS@FRS, Sandra Rosario/NY/FRS@FRS, Sarah Dahlgren/NY/FRS@FRS, Steven J Manzari/NY/FRS@FRS, Steven Mirsky/NY/FRS@FRS, Theodore Lubke/NY/FRS@FRS, Wendy Ng/NY/FRS@FRS, William BRODOWS/NY/FRS@FRS, William Hallacy/NY/FRS@FRS, Zahra El-Mekkawy/NY/FRS@FRS

cc

Subject memo re: Lehman's inter-company default scenario

RESTRICTED FR

Hello,

The attached memo is what Lehman's internal counsel described as their view on how a default for their B/D units may trigger a cascade of defaults through to the subs which have large OTC deriv books. Also attached is a spreadsheet showing the current status of the holding company's credit facilities (both syndicated and bilateral).

Let us know any questions..thanks!
chris



leh-def-scenario-memo-20080913.doc FundingFacilities.xls

Christopher Tsuboi
Federal Reserve Bank of New York
Bank Supervision/Operational Risk
212-720-2872
christopher.tsuboi@ny.frb.org

ATTACHMENTS RESTRICTED FR

Date: 13 September 2008

Subject: Lehman cross default scenarios as viewed by Lehman.

- This memo describes the opinion of Lehman's internal legal counsel on the probable course of events should a broker-dealer subsidiary of LBHI (the holding company) default on its obligations, with focus on a B/D default on its overnight funding obligations.
- The majority of securities financing is done out of the LBI (US B/D) and LBIE (UK B/D) subsidiaries. In these entities, repos are transacted under the standard BMA form of master purchase agreement (US) or GMRA agreements (UK). According to Lehman, these agreements are considered "standalone": that is, contractually speaking, a default by LBHI on its credit facilities does not necessarily trigger a default for the LBI subsidiary on its repo lines. In practice, it may become difficult to roll overnight repo in this event. Lehman stated that most of the immediate rollover risk resides with LBI, since LBIE transacts more term repo.
- LBIE has a corporate guarantee from LBHI, i.e. all LBIE obligations are ultimately obligations of LBHI.
- LBI does not have a corporate guarantee from LBHI, but because it is a "significant subsidiary" of LBHI, under its various **credit facility agreements** a shortfall of USD100M or more in respect of LBI and its overnight repo counterparties is considered an event of default for LBHI, and this in turn would trigger defaults at these credit facilities (both syndicated and bilateral). A list (current as of 9/12) of these credit facilities is in the accompanying spreadsheet, including information on capacity, utilization status and roll dates.
- Attachment A is a list of LBHI subsidiaries, grouped into those with guarantees by the holding company (LBHI) and those without.
- According to Lehman, a default in LBHI would trigger defaults in the other credit facilities, including the bilateral facilities, most of whose agreements are based on that of the main JPMC syndicated facility. The JPMC agreement is available and has been sent to Legal for review. The triggered defaults at these facilities would make them come due immediately.
- LBHI is named as a "Credit Support Provider" in the cross-default provisions in most of the **ISDA Master Agreements** for a number of subsidiaries with large OTC derivatives books. Thus a default at LBHI (passing a threshold of around USD100M) would trigger these provisions (q.v. 1992 ISDA Master Agreement section 5(a)(vi)). Most (roughly 80%) of the ISDA Master Agreements at these subsidiaries involve unmodified cross default provisions, while the rest modify the language to enable cross acceleration provisions, which requires positive acceleration of the debt by the creditor (a higher threshold for the trigger).
- The subsidiaries with the largest derivatives books are LBSF and LBIE. We still need to analyze data to understand the relative sizes of these books. Other subsidiaries with derivatives books are listed in Attachment A with the basic make-up of the books. In addition, Lehman is preparing more cross default and termination event data related to ISDA Master Agreements for the subsidiaries.
- One other significant trigger according to Lehman (outside the scenario described in this memo) would be termination events resulting from a ratings downgrade, in particular a downgrade to below investment grade (below BBB-).

TAB 63

[REDACTED]

From: Wilkinson, Jim
Sent: Sunday, September 14, 2008 11:59 AM
To: 'jes.staley' [REDACTED]
Subject: Re:

Ceos here talking abt bldg a private sector liquidity facility...what do u think?

From: jes.staley [REDACTED]
To: Wilkinson, Jim
Sent: Sun Sep 14 11:58:06 2008
Subject: Re:

Is the fire wall high enough?

----- Original Message -----
From: Jim.Wilkinson
Sent: 09/14/2008 09:17 AM AST
To: Jes Staley
Subject: Re:

At the end of the day fed will have to harden support to I banks...

----- Original Message -----
From: jes.staley [REDACTED]
To: Wilkinson, Jim
Sent: Sun Sep 14 09:11:25 2008
Subject: Re:

I think the market can take the Lehman unwind, but there needs to be a bid for Merrill early in the week. If Merrill goes, the whole 2a7 funding of Wall Street stops and the Fed will have to step in in a bigger way. Its getting heated here.

And I think people are getting that Paulson wont move.

Jes

Jes Staley
CEO - JPMorgan Asset Management
270 Park Ave, 47th Floor
New York, NY 10017
[REDACTED]

jes.staley [REDACTED]

Jim.Wilkinson@do.
treas.gov

09/14/2008 09:00
AM

jes.staley [REDACTED]

To

cc

Subject

Re:

No way govt money is coming in...I'm here writing the usg coms plan for orderly unwind...also just did a call with the WH and usg is united behind no money. No way in hell paulson could blink now...we will know more after thi ceo mtg this morning but I think we are headed for winddown unless barclays deal gets untangled

From: jes.staley [REDACTED]
To: Wilkinson, Jim
Sent: Sun Sep 14 08:53:42 2008
Subject: Re:

The issue here is can we end it a lehman. What's the solution for Merrill?
And who loses in the triparty unwind?
And what will you guys do in the end.
Jes

----- Original Message -----

From: Jim.Wilkinson
Sent: 09/14/2008 07:46 AM AST
To: Jes Staley
Subject: Re:

Here at the fed now...looking like a wind down to me...what's your sense?

In with paulson and geithner now and this doesn't seem like it is going to end pretty

From: jes.staley [REDACTED]
To: Wilkinson, Jim
Sent: Sat Sep 13 22:45:09 2008
Subject: Re:

What are your people saying?

----- Original Message -----
From: Jim..Wilkinson
Sent: 09/13/2008 08:59 PM AST
To: Jes Staley
Subject: Re:

Just called u back...left a voicemail...is there a better number for me to reach you on?

From: jes.staley [REDACTED]
To: Wilkinson, Jim
Sent: Sat Sep 13 20:41:42 2008
Subject: Re:

Just called.

----- Original Message -----
From: Jim.Wilkinson
Sent: 09/13/2008 08:03 PM AST
To: Jes Staley
Subject: Re:

You bet. Happy to give you an update. [REDACTED]

From: jes.staley [REDACTED]
To: Wilkinson, Jim
Sent: Sat Sep 13 19:58:08 2008
Subject: Re:

Likewise. Can I call later?

----- Original Message -----

From: Jim.Wilkinson

Sent: 09/13/2008 07:55 PM AST

To: Jes Staley

Still here working!

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TAB 64

Adam Ashcraft/NY/FRS

09/14/2008 09:31 AM

To

Jamie McAndrews/NY/FRS@FRS

cc

Alejandro LaTorre/NY/FRS@FRS, Arthur Angulo/NY/FRS@FRS, Beverly Hirtle/NY/FRS@FRS, Brian Peters/NY/FRS@FRS, Catherine Voigts/NY/FRS@FRS, Chris Burke/NY/FRS@FRS, Hayley Boesky/NY/FRS@FRS, Jim Mahoney/NY/FRS@FRS, Meg McConnell/NY/FRS@FRS, Patricia Mosser/NY/FRS@FRS, "Simon Potter" <simon.potter@ny.frb.org>, Til Schuermann/NY/FRS@FRS, Tobias Adrian/NY/FRS@FRS, Warren Hsung/NY/FRS@FRS

bcc

Subject

Re: AIG and the discount
window7BDE7A7EA83FFF6A852577120067E528

Answers:

AIG will have liquidity stress following downgrade from (a) collateral posting of about \$15 billion (b) loss of access to credit lines (c) potential run of investors funding repo positions of \$60 billion (d) wider asset spreads as markets anticipate asset sales.

The Citi research piece suggests the could raise \$20 billion by selling subs, but this is much less than their true value given distressed markets. Citi also notes that the firm could also hedge CDO risk with little effect on capital as these positions have been written down to fair value. A capital raise now would be highly dilutive given market prices, but I don't think we can justify access to the window based on the fact that shareholders don't want dilution.

I think that a case can be made to lend to them given the potential market disruptions of the unwind. However, if we do lend to them, it should have covenants requiring they give up all or part of the upside of the CDO exposures, and/or raise capital by selling subs or issuing equity.

Im in the bank if you want to talk about this further.

Adam B. Ashcraft
Financial Intermediation Function
Federal Reserve Bank of New York

3

The contents of this e-mail reflect the opinion of the author and not the opinion of the Federal Reserve Bank of New York or the Federal Reserve System.

TAB 65

From: Krishna.Guha@FT.com
Sent: Sunday, September 14, 2008 9:49 AM
To: Davis, MicheleDisabled
Subject: Re: Lehman query

But nothing further in terms of interim bridging support?
The PDCF is a liquidity facility, it does not provide any credit support.
I guess my question is would Hank in principle consider putting public capital at risk temporarily as a bridge while an agreed deal was implemented - eg by backstopping the bad bank portfolio on a temporary basis, or temporarily standing behind Lehman trades while a complex takeover was implemented?

----- Original Message -----

From: Michele.Davis
Sent: 09/14/2008 09:28 AM AST
To: Krishna Guha; Brookly.McLaughlin@do.treas.gov
Subject: Re: Lehman query

Off the record, his view is that the existing tools should be used as needed. Existing tools include the pdcf.

----- Original Message -----

From: Krishna.Guha@FT.com <Krishna.Guha@FT.com>
To: Davis, Michele; McLaughlin, Brookly
Sent: Sun Sep 14 09:12:39 2008
Subject: Lehman query

Would Paulson's firm no government money position rule out the government providing some short term bridging support eg while the acquisition of the problem asset portfolio by a consortium of Wall Street banks was organised and implemented?

I am trying to figure out whether the position is no public capital at risk at any point - or something that would in principle allow interim support so long as the end transaction was entirely private.

Please advise. It is important I don't end up mischaracterising Hank's position only for people to see an apparent climbdown if/when a deal is announced.

Best

K

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TAB 66

From: [Donald L Kohn](#)
To: Bernanke
Cc: [Brian F Madigan](#); [Kevin Warsh](#); [Scott Alvarez](#)
Subject: Re: Don and I are starting RB president calls
Date: 09/14/2008 03:03 PM

just talked to Kevin. LEH heard about the pdcf enlargement and thought it was a lifeline, but they didn't understand it was limited to triparty. KW thinks everything's on track for 4:30ish. SEC will go first announcing Chapt 11 for holding company. I haven't seen any details.

▼ Bernanke BOARD/FRS

Bernan
ke **BOARD/FRS**

09/14/2008 02:55 PM

To Kevin Warsh/BOARD/FRS@BOARD, Scott
Alvarez/BOARD/FRS@BOARD, Brian F
Madigan/BOARD/FRS@BOARD
cc Donald L Kohn/BOARD/FRS@BOARD
Subject Don and I are starting RB president calls

Anything new, Kevin?

Brian, Scott: Any more details on PDCF collateral, 23A details?

TAB 67

From: Bernanke
To: [Kevin Warsh](#)
Subject: re:
Date: 09/14/2008 04:16 PM

Anything to report?

In case I am asked: How much capital injection would have been needed to keep LEH alive as a going concern? I gather \$12B or so from the private guys together with Fed liquidity support was not enough.

TAB 68

[REDACTED]

From: Hoyt, Robert
Sent: Sunday, September 14, 2008 6:53 PM
To: Schaffer, Laurie
Subject: Re: Lehman

Thanks -- I hadn't heard that, but know they are working on relief in the wake of Lehman talks failing. It'll be quite a week I think.

From: Schaffer, Laurie
To: Hoyt, Robert
Sent: Sun Sep 14 17:24:32 2008
Subject: Lehman

Bob, I came in to the office and ran into the markets people. They said the Fed was going to take the following steps re: Lehman to address potential issues in the repo market.

1. Widen the collateral acceptable for the PDCF
2. Adjust the schedule related to certain auctions (I think)
3. Provide 23A (affiliate transaction relief) to the banks.

Laurie Schaffer

Assistant General Counsel (Banking and Finance)

Department of the Treasury

[REDACTED]

[REDACTED]

TAB 69

From: Charles.Holm@frb.gov
To: [Robert Maahs](#)
Subject: Fw: Todays events/23a
Date: 09/14/2008 07:22 PM
Attachments: [23a.doc.doc](#)

Fyi
Sent by Blackberry Wireless

----- Original Message -----
From: Charles Holm
Sent: 09/14/2008 07:21 PM EDT
To: Laurie Priest
Subject: Fw: Todays events/23a

Fyi
Sent by Blackberry Wireless

----- Original Message -----
From: Deborah P Bailey
Sent: 09/14/2008 06:13 PM EDT
To: Molly Wassom; Kevin Bertsch; Betsy Cross; Jack Jennings; Coryann Stefansson; Lisa DeFerrari; Jon Greenlee; Richard Naylor; Tim Clark; Charles Holm; Barbara Bouchard; William Treacy; Arthur Lindo
Cc: Roger Cole; Ryan Lordos; William Spaniel
Subject: Todays events/23a
Lots going on ...and little of it is good! Unless it is something critical, Norah and I would like you to limit your travel this week.
Thanks

There will be some changes in the PDCF facility with reference to eligible collateral and the TSLF has been expanded to include all investment grade debt securities. I am not sure of the time of the announcement.

I have attached below the draft final notice for the 23a exemption...In short, it applies to those institution which are engaged in triparty repo through JPMC and BNY. There are caveats around certain elements however it is important to note that an institution is eligible unless they are specifically told by the FRB and/or the primary supervisors that they are not eligible.

Please pass on as appropriate . Please let us know if you need broader communications.

(See attached file: 23a.doc.doc)



[- 23a.doc.doc](#)

For the reasons set forth in the preamble, Chapter II of Title 12 of the Code of Federal Regulations is amended as follows:

PART 223 -- TRANSACTIONS BETWEEN MEMBER BANKS AND THEIR AFFILIATES (REGULATION W)

1. The authority citation for part 223 continues to read as follows:

Authority: 12 U.S.C. 371c and 371c-1.

2. In section 223.42, add section 223.42(n):

§ 223.42 What covered transactions are exempt from the quantitative limits, collateral requirements, and low-quality asset prohibition?

* * * * *

(n) Securities financing transactions. (1) From September 15, 2008, until January 30, 2009 (unless further extended by the Board), securities financing transactions with an affiliate, if:

(i) The security or other asset financed by the member bank in the transaction is of a type that the affiliate financed in the U.S. tri-party repurchase agreement market at any time during the week of September 8-12, 2008;

(ii) The transaction is marked to market daily and subject to daily margin-maintenance requirements, and the member bank is at least as over-collateralized in the transaction as the affiliate's clearing bank was over-collateralized in

comparable transactions with the affiliate in the U.S. tri-party repurchase agreement market on September 12, 2008;

(iii) The aggregate risk profile of the securities financing transactions under this exemption is no greater than the aggregate risk profile of the securities financing transactions of the affiliate in the U.S. tri-party repurchase agreement market on September 12, 2008;

(iv) The member bank's top-tier holding company guarantees the obligations of the affiliate under the securities financing transactions (or provides other security to the bank that is acceptable to the Board); and

(v) The member bank has not been specifically informed by the Board, after consultation with the member bank's appropriate Federal banking agency, that the member bank may not use this exemption.

(2) For purposes of this exemption:

(i) Securities financing transaction means:

(A) A purchase by a member bank from an affiliate of a security or other asset, subject to an agreement by the affiliate to repurchase the asset from the member bank;

(B) A borrowing of a security by a member bank from an affiliate on a collateralized basis; or

(C) A secured extension of credit by a member bank to an affiliate.

(ii) U.S. tri-party repurchase agreement market means the U.S. market for securities financing transactions in which the counterparties use custodial arrangements provided by JPMorgan Chase Bank or Bank of New York or another financial institution approved by the Board.

By order of the Board of Governors of the Federal Reserve System, _____,
2008.

Jennifer J. Johnson,
Secretary of the Board.
BILLING CODE 6210-01-P

TAB 70

From: [Deborah P Bailey](#)
To: [Scott Alvarez](#); [Brian F Madigan](#)
Cc: [Coryann Stefansson](#); [Norah Barger](#)
Subject: collateral-- tri party
Date: 09/14/2008 07:23 PM
Importance: High
Attachments: [Lehman and Merrill triparty from Friday.xls](#)

FYI. I received from FRBNY



Lehman and Merrill triparty from Friday.xls

Sat Sep 13 15:22:31 EDT 2008

Triparty Collateral Analysis

Customer	Item Count	Collateral Value Including Accrued Interest	Collateral Value After Margin Reductor	Effective Margin %
11-LEHMAN BROTHERS 1-FRB Securities	US Treasuries and Strips	\$22,192,197,941.50	\$21,870,059,122.19	101.47%
	Freddie Mac & Fannie Mae MBS	\$21,486,061,277.53	\$20,773,912,803.83	103.43%
	US Government Agency Securities	\$7,944,315,385.52	\$7,849,096,343.76	101.21%
	Freddie Mac & Fannie Mae REMICs	\$2,027,192,130.16	\$1,941,672,000.42	104.40%
	Ginnie Mae MBS Pools	\$534,128,905.29	\$521,211,945.79	102.48%
	Ginnie Mae REMICs	\$478,390,092.93	\$456,023,698.94	104.90%
		\$54,662,285,732.93	\$53,411,975,914.93	
2-DTC Fixed Income Securities Investment Grade	Corporate Bonds	\$6,815,633,488.61	\$6,368,450,147.33	107.02%
	Commercial Paper	\$4,690,516,434.82	\$4,346,379,090.10	107.92%
	Other	\$115,141,390.81	\$112,761,796.38	102.11%
	Private Label CMO	\$4,425,982,807.90	\$4,063,809,618.59	108.91%
	Asset Back Securities	\$3,191,621,072.49	\$2,855,191,046.83	111.78%
	Municipal Bonds	\$1,099,139,698.42	\$1,034,140,556.09	106.29%
		\$20,338,034,893.05	\$18,780,732,255.32	
Non-Investment Grade	Other	\$90,713,505.60	\$89,929,487.87	100.87%
	Corporate Bonds	\$3,027,145,049.38	\$2,674,176,032.18	113.20%
	Asset Back Securities	\$1,525,685,336.91	\$1,175,186,924.09	129.82%
	Municipal Bonds	\$871,684,859.54	\$805,616,583.38	108.20%
	Private Label CMO	\$375,162,664.39	\$313,454,292.76	119.69%
	Commercial Paper	\$258,840,551.13	\$246,577,370.37	104.97%
		\$6,149,231,966.95	\$5,304,940,690.65	
3-DTC Equities Investment Grade		\$26,487,266,860.00	\$24,085,672,945.97	
	Equities & Equity Derivatives	\$173,701,302.31	\$165,428,805.69	105.00%
	Equities & Equity Derivatives	\$173,701,302.31	\$165,428,805.69	
	Equities & Equity Derivatives	\$6,682,349,443.65	\$6,277,920,699.08	106.44%
	Equities & Equity Derivatives	\$6,682,349,443.65	\$6,277,920,699.08	
		\$6,856,050,745.96	\$6,443,349,504.77	
Non-Investment Grade				
	Equities & Equity Derivatives	\$3,425,143,990.95	\$3,424,863,226.15	100.01%
	Equities & Equity Derivatives	\$3,425,143,990.95	\$3,424,863,226.15	
4-Other	5-Cash as collateral	\$3,410,825,000.00	\$3,410,825,000.00	100.00%
		\$3,410,825,000.00	\$3,410,825,000.00	
5-Cash				

TOTAL Unwind:

\$94,841,572,329.84

Redacted Material

\$90,776,686,591.82

From: [Coryann Stefansson](#)
To: [Brandon Hall](#)
Subject: Re: Reverse Counterparty Analysis I (Lehman Brothers)
Date: 09/14/2008 08:56 PM

Can u send the table as an attachment so we can see on bb?

Thanks so very very much!! And good work!!

Coryann Stefansson

Associate Director

Bank Supervision and Regulation

▼ Brandon Hall

----- Original Message -----

From: Brandon Hall
Sent: 09/14/2008 08:37 PM EDT
To: BSR LFIC
Cc: Dianne Dobbeck; Richard Cahill
Subject: Reverse Counterparty Analysis I (Lehman Brothers)

RESTRICTED FR

This note summarizes the results of a Reverse Counterparty Analysis for Lehman Brothers. We examined LFI exposures to Lehman Brothers in comparison with Lehman's own view of its counterparty payables to the LFIs. Via this comparison, it is possible to draw out major discrepancies regarding key counterparty exposure names and magnitudes. The Lehman version below represents the first of a multi-part analysis, which will also encompass ^{Material Redacted} forward.

According to the firm's data, Lehman has **\$24.6B** in counterparty current exposure payables to the market. By sector, nearly half (45%) of Lehman's payables are to hedge funds, with 16% payable to commercial banks. **LFI payables amount to \$818MM or 3% of total.**

(USD Millions)

Sector	Due from Lehman	% of Total
Hedge Funds	11,029	45%
Commercial Banks	3,972	16%
...of which LFIs	818	3%
Mutual Funds	1,724	7%
Other	7,918	32%
Total	24,642	

Lehman's view of its LFI exposure payables (\$818MM) differs from the LFIs' view of exposure receivables (\$2.0B) -- just over \$1B MTM. A significant portion of this \$1B gap is potentially explained by collateral netting, differences in metric, and/or collateral valuation differences. We do not perceive this difference between LEH's view and that of the LFIs to be significant.

Specifically (see table below),

- SocGen reports \$662MM in exposure to Lehman, while Lehman reports a nearly flat position of \$9MM, possibly explained by a difference in exposure metric as well as collateral netting.
- Credit Suisse reports \$179MM, while Lehman reports \$38MM, possibly due to collateral netting.
- BNP Paribas reports \$742MM in exposure, whereas Lehman reports \$294MM, possibly due to a difference in metric.

It should be noted that estimates of counterparty risk and exposures are extremely fluid. For example, JPMC reports today that they do not have confidence in a MTM number, given the dynamics of how underlying risk factors will react when markets open tomorrow.

(USD Millions)

LFI View: Exposure due from LEH				LEH View: Exposure due to LFI			
Institution	As of Date	Current Exposure	Potential Exposure	As of Date	MtM	Collateral	CCE due to LFI
BIPPP ¹	09/09/08	\$743	\$967	09/11/08	-\$959	-\$664	\$294
Citigroup	09/10/08	\$207	\$2,600	09/11/08	-\$121	\$1	\$122
RBS/ABN	09/11/08	\$50	\$6,400	09/11/08	\$190	\$304	\$114
JPMC	09/10/08	\$30	\$1,590	09/11/08	-\$172	-\$122	\$50
UBS	09/09/08	\$0	\$1,200	09/11/08	-\$185	-\$105	\$79
Deutsche	09/10/08	\$0	Not Calc	09/11/08	\$194	\$260	\$66
BAC	09/09/08	\$143	\$887	09/11/08	\$266	\$311	\$46
CS	09/11/08	\$179	\$1,385	09/11/08	-\$171	-\$133	\$38
SocGen	09/09/08	\$662	\$776	09/11/08	-\$5	\$4	\$9
Barclays	09/08/08	\$30	\$2,080	09/11/08	-\$4	-\$2	\$1
Total		\$2,044			-\$966	-\$147	\$818

Please call with any questions,
Brandon Hall and Jordan Pollinger

Brandon J. Hall
Counterparty Credit Risk Monitoring & Analysis
Federal Reserve Bank of New York
33 Liberty St. | New York, NY 10045

P: 212-720-1349
F: 212-720-1468
E: brandon.hall@ny.frb.org

TAB 71

From: [Mark VanDerWeide](#)
To: [Scott Alvarez](#)
Cc: [Rich Ashton](#)
Subject: lehman and the PDCF
Date: 09/15/2008 09:33 AM

Scott:

Are you OK with Lehman b/d accessing the PDCF today in light of its parent's chapter 11 bankruptcy? Or should we talk about this one more time. I think Baxter is doing some analysis/writeup on this issue.

Mark