

HUGHES HUBBARD & REED LLP
One Battery Park Plaza
New York, New York 10004
Telephone: (212) 837-6000
Facsimile: (212) 422-4726

Attorneys for James W. Giddens,
Trustee for the SIPA Liquidation of
Lehman Brothers Inc.

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re

LEHMAN BROTHERS INC.,

Debtor.

Case No. 08-01420 (JMP) SIPA

**TRUSTEE'S PRELIMINARY INVESTIGATION REPORT
AND RECOMMENDATIONS**

TABLE OF CONTENTS

	Page
<u>INTRODUCTION</u>	1
I. EXECUTIVE SUMMARY	4
II. Procedural Background.....	10
III. LBI'S HISTORICAL BACKGROUND.....	13
A. LBI Pre-1965	13
B. LBI 1965-1994.....	14
C. LBI 1994-2008 — A Period Of Record Growth And Profits — And Increasing Risk.....	15
D. The Business Of The Modern Broker-Dealer.....	17
E. Regulatory Oversight.....	18
1. The Financial Responsibility Rules	19
2. The CSE program	21
IV. KEY FEATURES OF LBI'S BUSINESS AND WHAT HAPPENED TO THEM BY THE TIME OF THE LIQUIDATION	25
A. What Happened By The Time Of The Liquidation	27
1. Inability to obtain financing from third parties and affiliates.....	28
2. Customer relationships.....	30
3. Additional collateral requirements and clearing organization actions	34
(a) JPMC.....	34
(b) Citibank.....	36
(c) Clearing organization actions	37
4. Increase in failed transactions.....	37

TABLE OF CONTENTS

	<u>Page</u>
B. LBI's Business In Relation To Lehman's Corporate Structure And Some Of Its Ramifications	39
1. Transactions with or involving other Lehman entities	40
(a) Repo agreements with affiliates and other entities	42
(b) Prime brokerage accounts	44
(c) Certain LBI subsidiaries	47
2. The role of clearing banks and LBHI in financing LBI and its subsidiaries.....	52
3. Some relevant aspects of the LBI-LBIE relationship	56
(a) Daily operations of the LBI-LBIE relationship	56
(b) LBIE Acting as Settlement Hub for Transactions in Europe and Certain Jurisdictions.....	57
V. SOME CONSEQUENCES OF LBHI'S INSOLVENCY FILING AND THE IMMINENCE OF THE SIPA LIQUIDATION.....	60
A. Immediate Impacts Of Insolvency Filings.....	60
1. CME's reaction to LBHI's insolvency and LBI's impending liquidation	64
2. OCC's reaction to LBHI's insolvency and LBI's impending liquidation	68
3. DTCC's reaction to LBHI's insolvency and LBI's impending liquidation	70
4. The DTCC-ACATS reversals.....	71
B. The Impact Of The Insolvency Filings On The LBI-LBIE Relationship	74
C. Prime Brokerage Accounts, Reconciliation Status And The Trustee's Protocol.....	75
D. Lehman's Communications With Customers About SIPA	76

TABLE OF CONTENTS

	<u>Page</u>
VI. ADDITIONAL INFORMATION ON FOUR ITEMS RELATING TO LBI MENTIONED IN THE EXAMINER'S REPORT.....	80
A. Potential Avoidance Actions — Below-Market Trades	81
B. The SEC Never Granted Approval For The Release Of Customer Funds	82
C. Repo 105/108.....	83
D. HSBC Deposit.....	84
VII. CERTAIN CHALLENGES OF THE LARGEST BROKER-DEALER LIQUIDATION IN HISTORY.....	85
A. Overview: Evolving Events Hinder Careful Planning.....	86
B. Transfer vs. Non-Transfer Of Customer Accounts: Legal And Practical Implications.....	89
C. Incorrect Assumptions And Unanticipated Impediments	91
D. The Customer Accounts Included In The SIPA Proceeding	94
1. Prime brokerage assets.....	95
2. The unknown universe of non-PIM, non-PAM accounts	96
3. The LBIE clearing and house customer accounts.....	97
4. The affiliate customer claims.....	98
E. The Largest Broker-Dealer Liquidation Ever	99
F. SIPA And The Customer Protection Rules Scheme Largely Worked Well In Spite Of It All	100
VIII. SOME LESSONS AND CAUTIONARY TALES.....	101
A. SIPA: More Than An Afterthought	102
B. The Desirability Of Account Transfers And Costs Of Partial Account Transfer.....	102
C. The Information And Operations Gap	105

TABLE OF CONTENTS

	<u>Page</u>
IX. RECOMMENDATIONS FOR FUTURE LIQUIDATIONS WITH CUSTOMER IMPLICATIONS, WHETHER UNDER SIPA OR ANOTHER ORDERLY LIQUIDATION AUTHORITY	111
A. The Need For Planning And Early Involvement Of Representatives Of Customers' Interests.....	111
B. A Required Liquidation Plan	112
C. Planning Beyond The Broker-Dealer: Third Party Holders Of Margin, Deposits And Collateral.....	115
D. Possible Requirement For Additional Court Findings.....	122
E. Clearing Bodies, Set Off And Liquidation Rights, Visibility And Access To Information — Balancing Safe Harbors With Quid Pro Quos For The Protection of Customers.....	123
F. Must There Be A Single Fund Of Customer Property?.....	127
G. Reasonable Enhancement Of The SIPC Fund And Borrowing Or Guarantee Authority.....	134
H. Tailoring Safe Harbors To SIPA: Short Term Stays And Consensual Relief.....	136
I. Tailoring Safe Harbors To SIPA: Achieving Fairness And Finality For Close-Outs.....	140

INTRODUCTION

1. James W. Giddens (the “Trustee”), as Trustee for the liquidation of Lehman Brothers Inc. (the “Debtor” or “LBI”), respectfully submits this Preliminary Report and Recommendations (“Preliminary Report”). As the Court is aware, the Securities Investor Protection Act, 15 U.S.C. § 78aaa *et seq.* (“SIPA”), mandates that the Trustee investigate and report on, *inter alia*, the financial condition and business affairs of the debtor. The Trustee’s team of professionals is conducting this investigation and the Trustee plans to report on his findings at the conclusion of these liquidation proceedings as is customary.

2. After any disaster, the post-event discussion is focused on changes that might be made to prevent a similar disaster from occurring again, and how to respond more effectively and efficiently in the face of future disasters. The Great Chicago Fire of 1871, for example, led the way for modern construction made of brick and stone, rather than wood, and inspired improved building and fire codes. The disaster that was the collapse of Lehman is no exception. Since the events of September 2008, experts, politicians and pundits have explored various types of financial reform that might be implemented to prevent another “Lehman” from taking place. Indeed, at the present time, significant federal financial reform legislation has just been enacted.¹ And, earlier this year, in Lehman Brothers Holdings Inc.’s (“LBHI”) Chapter XI

1. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (2010) (the “Dodd-Frank Act”). Although this Preliminary Report addresses certain potential effects of the Dodd-Frank Act on a broker-dealer liquidation, it does not do so in detail or in each circumstance where the Act may have an impact, given that the Act in many respects delegates to regulatory agencies the obligation to conduct studies and the authority to issue the appropriate implementing regulations.

proceeding,² the Lehman crisis was fully explored in the extensive report released by the Examiner appointed by this Court.³

3. These efforts are more far-reaching and broader than the Trustee's mandate here, which is to focus solely on LBI, the United States broker-dealer subsidiary of LBHI.⁴ Indeed, the Examiner's Report, and nearly all of the public commentary and analyses of events of September 2008 that culminated with LBHI's Chapter XI filing and LBI's SIPA proceeding, have focused on the collapse of LBI's parent, LBHI. The Trustee believes, therefore, that sharing some of the practical lessons learned from the LBI liquidation, along with his recommendations specific to future liquidations of broker-dealers, will be timely and relevant to the issues currently under consideration by legislators and regulators.

4. The difference in focus of this Preliminary Report as compared to other efforts is critical. While some, for example, have sought major reforms to regulatory agencies, the Trustee believes that, insofar as the supervision of LBI's basic operations as a broker-dealer is concerned, the regulatory scheme, as well as the regulators themselves and Lehman's internal compliance function, largely did their jobs. During periods of normal operation, LBI was generally in compliance with regulatory requirements and the financial responsibility and customer segregation rules specific to the operation of the broker-dealer. The circumstances within which LBI's liquidation was commenced and has had to be conducted have created a

2. *In re Lehman Brothers Holdings Inc.*, No. 08-13555 (JMP) (Bankr. S.D.N.Y. 2008) ("LBHI Docket"), available at <http://www.lehman-docket.com>.

3. Report of Anton R. Valukas, Examiner (LBHI Docket No. 7532), available at <http://lehmanreport.jenner.com/> (the "Examiner's Report").

4. The overall scope of the Examiner's Report, as detailed by the Court with ten specific bulleted topics for the Examiner to investigate, was the failure of LBHI. See Order Directing Appointment of an Examiner Pursuant to § 1104(c)(2), (LBHI Docket No. 2569).

unique set of obstacles. But, SIPA still worked to facilitate massive account transfers and otherwise protect LBI's customers, even in the case of an entity as large and complex as LBI and even in a time of uncertainty and financial turmoil. This is not to say that circumstances have permitted a perfect liquidation or that improvements in industry preparedness and liquidation proceedings themselves cannot be made, and the Trustee sets forth his recommendations on these and other topics in Section IX.

5. By the week of September 15, 2008, LBHI and certain affiliated companies had already commenced insolvency proceedings in the United States and abroad. It was the most tumultuous time in our country's financial history since the Great Depression, and the Lehman collapse became its defining moment. While it was a foregone conclusion that LBI would not survive as an independent entity, little else was certain.

6. LBI's liquidation arose from the chaos of a failed attempt by Lehman management to save the firm by either raising capital and selling targeted assets, or finding a buyer that would buy all or most of the enterprise. When the anticipated sale to Barclays Capital Inc. ("Barclays" or "BCI") failed, the plan changed to an orderly wind-down orchestrated by the Federal Reserve Board of New York ("FRBNY"). A degree of disorder nevertheless ensued because of the loss of confidence in Lehman as a whole following LBHI's Chapter XI filing and the not fully-anticipated freezing of European transactions with Lehman Brothers International (Europe) ("LBIE"), the principal European broker-dealer within the Lehman enterprise, after it was placed in administration in the United Kingdom. The wind-down was also interrupted by the re-emergence of Barclays as the acquirer of selected, but not all, broker-dealer assets and customer accounts.

7. This Preliminary Report is based on the Trustee's investigative efforts to date, which remain ongoing. The Trustee is engaged in active litigation and pre-litigation activities, such that a report on certain topics at this time would be inappropriate. Indeed, this is another difference between the Trustee and the Examiner, who was a neutral outsider with respect to the matters he investigated. For these reasons, this Preliminary Report does not address all of the matters that have been or will be the subject of the Trustee's investigation and further reporting. The Trustee anticipates that by the conclusion of what is expected to be a necessarily complex liquidation proceeding, he will submit additional reports that will focus on other investigative areas set forth in SIPA, such as the examination of causes of action.⁵ The Trustee also files detailed narrative interim reports every six months which describe the progress of the liquidation, investigation and principal issues that the Trustee is pursuing. The most recent of those reports covers the period through May 10, 2010.⁶

I. EXECUTIVE SUMMARY

8. The Trustee has prepared this Preliminary Report as part of his statutory duty to report on the reasons for the debtor's failure and, as is traditional, to identify problems that could be remedied in future liquidations, including some recommended reforms for consideration by the Court, Congress and relevant regulatory bodies. Such reports are often issued at or near the end of a SIPA liquidation, but the magnitude of Lehman and the fact that many aspects of the recently enacted financial reform legislation are now being worked out

5. Because the Trustee continues to evaluate potential claims resulting from the LBI liquidation, which he will identify at the end of his investigation, certain information and details are omitted from this Preliminary Report to avoid prejudice to the future prosecution of those claims or potential unfairness to other parties involved.

6. See Trustee's Third Interim Report for the Period November 12, 2009 through May 10, 2010, *In re Lehman Brothers Inc.*, No. 08-01420 (JMP) (Bankr. S.D.N.Y. 2008) ("LBI Docket") (LBI Docket No. 3244), available at www.lehmantrustee.com (the "Trustee's Third Interim Report").

makes such a report a little less than two years into the LBI liquidation timely and appropriate in the Trustee's view. The authority to conduct the investigation that has led to this report is contained in SIPA § 78fff-1(d)(1)⁷ and was confirmed by this Court's order of January 15, 2009.⁸

9. This Report does not report on all potential causes of action or other matters that are or are likely to be subjects of litigation. They and other matters will be the subjects of future reports. Rather, this Report focuses on an overview of LBI's relationship with some of the other Lehman entities; the dissipation of LBI's assets following the well-publicized Bear Stearns emergency in the Spring of 2008 as affected by LBI's relationships with other Lehman entities; and lessons learned and recommendations for the future based on that history and the course of the liquidation to date. The Report is accompanied by a summary chronology that may be helpful to readers.

10. The Report does not purport to be an insolvency analysis or an in depth financial review and seeks to avoid comment, insofar as possible, on matters likely to be subject to litigation involving the Trustee.

11. The Preliminary Report concludes that, at least until relatively late in the day when panic and confusion set in, LBI's compliance with the regulatory requirements designed for the protection of customer property was good, and the requirements largely had the effect they were supposed to have. With a few important exceptions adverted to in the Report

7. 15 U.S.C. § 78fff-1(d)(1) (subsequent citations to the SIPA statute exclude "15 U.S.C."); *see also* SIPA §§ 78fff-1(d)(1), (3), (4).

8. Order Granting Authority to Issue Subpoenas for the Production of Documents and the Examination of the Debtor's Current and Former Officers, Directors and Employees, and Other Persons (LBI Docket No. 561) (the "Subpoena Authority Order") (**Exhibit A**).

and now in litigation, most customer property was intact and accessible for satisfaction of customer claims or transfer to other brokers — precisely the purpose of the regulations. This was particularly true of the customer property located in the United States; obtaining that which was or should have been held in foreign depositories has proved more challenging and has met with less immediate success.

12. For the most part, SIPA also worked well, permitting implementation of the largest account transfers in history. These transfers provided nearly seamless treatment to the vast majority, though regrettably not all, LBI customers, avoiding loss and disruption to them and the market as a whole. The remaining claims, though small in relation to the number and value of accounts transferred, have nevertheless generated a claims process which is by far the largest and most complex in the history of SIPA or broker-dealer liquidations generally. In fact, administration of any of the four remaining groups of claims — accounts not included in the Private Investment Management (“PIM”) or Private Asset Management (“PAM”) ranges of transferred accounts for a variety of reasons, certain prime brokerage accounts (“PBAs”), claims under the LBIE/LBI omnibus account through which LBI served as U.S. clearing broker for LBIE and its customers, and claims by LBHI and other Lehman affiliates — would each in itself dwarf virtually any previous broker-dealer liquidation.

13. The lessons learned and a description of the practical issues the Trustee has faced appear primarily in Sections IV, V, VII and VIII of the Report. Specific recommendations for these and other issues or potential improvements in the operation of the SIPA process are set forth in the concluding Section IX. Some of the lessons learned and problems discussed relate to the particular structure of the transaction with Barclays. The transaction agreed to by the holding company left LBI, a defunct broker-dealer, sandwiched

between, on the one hand, LBHI, a holding company entering Chapter XI with a desire to shed liabilities and retain businesses and assets, and, on the other, an entity selectively acquiring some customer accounts and buying some assets while seeking to de-risk the transaction. While another major liquidation might differ in detail, Lehman, in the Trustee's view, presents a cautionary tale on the unexpected dangers inherent in this structure. The Lehman experience underscores the need for better information, better planning, and better communication, whether in a stand-alone SIPA liquidation or as part of a liquidation involving a Federal Deposit Insurance Corporation ("FDIC") takeover of some assets under the new financial authority legislation.

14. In general, with some exceptions, the Trustee has been regularly disappointed in the performance and attitudes of many entities with which he has had to interact or which hold LBI property or information. While there have been professions of cooperation, deeds have spoken louder than words. In too many cases the deeds have shown a pattern of delay, incomplete information and creation of obstacles. Similarly — and again with a few exceptions — parties have seemed all too willing to take extreme positions in order to claim a right to what was intended to be customer property, to claim customer status for themselves for ordinary financial or intercompany transactions, or to withhold property clearly belonging to the LBI estate until the last possible moment under threats of litigation. This attitude of hiding and then holding onto the ball until the referee is about to blow the whistle has greatly hindered the Trustee's work and frustrated SIPA's underlying goals.

15. These attitudes contrast sharply with those that prevailed in earlier SIPA liquidations of New York stock exchange firms in which the Trustee and his counsel have been involved. In those earlier liquidations, a paramount concern for protection of customers and

proving that the customer scheme worked when it was needed caused prominent actors largely to forego gamesmanship and strategic behavior. Admittedly, those liquidations were many years ago; their stakes were lower and the complexity much less. But, at bottom, the industry seems to have forgotten that its success or failure still depends to a large extent on the confidence of customers. Even though many accounts at LBI were large and in some cases quite sophisticated, the underlying sense that customers will be protected and dealt with fairly remains a key foundation of the industry, one that it ought not to contribute to eroding through narrow conceptions of self-interest and focus on minor tactical advantages.

16. To that end, the Report contains eight principal specific recommendations and ideas for further consideration. Most could be implemented by regulation, or in some cases industry agreement; a few would require legislation. The recommendations are primarily practical, rather than theoretical, in focus. If there ever is to be a “second” Lehman, the recommendations are designed to avoid a later trustee having to encounter some of the largely unforeseen impediments encountered by this Trustee.

17. Principal recommendations include:

- More pre-liquidation disaster planning, both on an individual broker-dealer and industry-wide basis, including what a broker-dealer’s “living will” and emergency plan should include to alleviate the type of information gap which has confronted the Trustee in the LBI liquidation.
- Proposals for more robust and earlier pre-liquidation negotiation and focus by liquidators and regulators on the mechanics and consequences of transactions such as partial customer account

transfers. Specifically, attention needs to be paid to provisions for access to assets, information systems and people, including a possible requirement of judicial findings on some of these issues prior to approval of transactions and extending the time for settling transactions after the filing date.

- Balancing clearing banks' and others' safe harbor rights against the needs for transparency and respect for broker-dealers' obligations to segregate customer property in order to prevent denial of access to screens and seizure of that which should be segregated customer property.
- Study of clearing agencies' emergency rules so that the rules function as expected in emergencies, the operation and consequences of the emergency rules are better understood and the results strike the proper balance among competing interests.
- Suggestions for possible reconsideration of the unitary nature of the fund of customer property in favor of funds tailored to different forms of accounts, to correspond to customer expectations and differences in account relationships.
- Increasing SIPC's financial resources and borrowing authority in a prudent way that minimizes taxpayer costs but adds flexibility in the purposes for which such financial resources could be used.
- Recommendations for short term reinstatement of the automatic stay with provision for SIPC and a SIPA trustee to consent to relief

to permit prompt liquidation of collateral and return of excess or marking to market to cure deficiencies.

- Rational rules for unwinding outstanding non-customer financial transactions on terms that protect both the broker-dealer's estate and counterparties while providing certainty and reducing costs.

II. PROCEDURAL BACKGROUND

18. On September 15, 2008, LBHI and certain of its subsidiaries, excluding LBI, commenced voluntary cases (the "Chapter XI Cases") under Chapter XI of Title XI of the United States Code (the "Bankruptcy Code").

19. The commencement of the insolvency proceedings of the corporate parent substantially limited the daily funding sources of those LBHI affiliates and LBI subsidiaries that remained in operation as of September 15. As a result, LBI was only able to continue its operations by borrowing approximately \$45 billion (backed by collateral valued much greater than that) from the FRBNY starting on Monday, September 15 (the "FRBNY Repo").

20. On September 19, 2008, on the application of the Securities Investor Protection Corporation ("SIPC"), the Honorable Gerard E. Lynch, then a United States District Judge for the Southern District of New York, entered an Order Commencing Liquidation (the "LBI Liquidation Order") pursuant to the provisions of SIPA.⁹

21. The LBI Liquidation Order, *inter alia*: (i) appointed James W. Giddens as Trustee for the liquidation of the business of LBI pursuant to SIPA § 78eee(b)(3); (ii) appointed

9. *Securities Investor Protection Corp. v. Lehman Brothers Inc.*, Case No. 08-CIV-8119 (GEL) (LBI Docket No. 1) (the "LBI Liquidation Order") (**Exhibit B**).

Hughes Hubbard & Reed LLP (“HHR”) counsel to the Trustee pursuant to SIPA § 78eee(b)(3); and (iii) removed the case to this Court pursuant to SIPA § 78eee(b)(4) (the “SIPA Proceeding”).

22. This SIPA Proceeding is “by far the largest and most complex” securities broker-dealer liquidation ever attempted.¹⁰ As of July 30, the LBI estate contained approximately \$17 billion of cash and securities, but the SIPA Proceeding has involved the administration or transfer of well over \$110 billion of cash and securities. Working in cooperation with SIPC, the U.S. Securities and Exchange Commission (“SEC”), the Commodity Futures Trading Commission (“CFTC”), the FRBNY, the Depository Trust & Clearing Corporation (“DTCC”), and former LBI personnel, the Trustee has effectuated the transfer of over 110,000 customer accounts involving customer property with a value in excess of \$92.3 billion. This Court approved the customer account transfers on December 14, 2009.¹¹ Over the course of the SIPA Proceeding, more than 12,500 customer claims, seeking in excess of \$66 billion, were filed. The Trustee has determined all customer claims other than those of affiliates that are now in final stages of review or reconciliation. Over 1,300 objections to the Trustee’s determinations have been filed for court determination. Approximately one hundred of these objections have been denied by the Court or have been withdrawn, and more are in the process of briefing, exchange of information and discussion.

10. Memorandum Decision Granting Motion of DCP Parties for Leave to Conduct 2004 Discovery, at 4 (LBI Docket No. 353).

11. Order Pursuant to SIPA Section 78 fff-2(f), 11 U.S.C. 105(a) and 363(b) and Fed. R. Bank. P. 9019(a) Approving the Trustee’s Implementation of the LBI Liquidation Order to Complete the Account Transfers for the Benefit of Customers, Including the Related Limited Settlement Agreement Completing the PIM Conversion for the Benefit of Private Investment Management Customers, and Terminating the Account Transfer Process (LBI Docket No. 2338).

23. In furtherance of his investigative obligations, the Trustee obtained permission of the Court by Order dated January 15, 2009 to issue subpoenas,¹² and since then has been actively engaged in pursuing numerous avenues of investigation. The Trustee agrees with the conclusion of the Examiner, set forth in the April 1, 2010 letter to the U.S. Trustee, that having subpoena power is “equally as important [as] not to have to use it.”¹³ To date, the Trustee’s professionals have conducted over 200 interviews of former Lehman employees and third parties, all of which have occurred without having to deploy the Trustee’s subpoena power, although recently some subpoenas for testimony have been issued. Further, with a handful of exceptions, the Trustee has proceeded to collect hundreds of thousands of pages of documents from third parties on a voluntary basis. The Trustee has averted to the possibility of using his subpoena power numerous times in discussions with information sources and, in keeping with this Court’s instruction that the Trustee issue subpoenas as necessary, will not hesitate to use this power if voluntary cooperation is not forthcoming or meaningful.

24. The Trustee also coordinated his investigative efforts to the extent practicable and appropriate with the Examiner, the various regulatory authorities, and other third parties. This coordination was critically important to the progress of the Trustee’s investigation, his findings and conclusions to date, and the Trustee’s ability to avoid duplicative efforts to the greatest extent possible. The Trustee deeply appreciates the Examiner’s professionalism, thorough work, courtesies and understanding of the need to “stand down” cooperatively on certain issues that are particularly within the Trustee’s purview.

12. Subpoena Authority Order (**Exhibit A**).

13. Letter from Anton R. Valukas, Examiner, to Diana Adams, U.S. Trustee (Apr. 1, 2010), at 7 (LBHI Docket No. 8626).

25. Additional and detailed summaries of the Trustee's works and progress of the liquidation are contained in the Trustee's Interim Reports, the most recent of which was filed on May 10, 2010.¹⁴

III. LBI'S HISTORICAL BACKGROUND¹⁵

A. LBI Pre-1965

26. The history of Lehman Brothers, from its mid-19th century founding by German immigrants as a dry goods merchant, to its ascension to, and ultimate fall from, the ranks of the world's elite investment banks, has been well documented and extensively discussed.¹⁶ The modern era of LBI as a registered broker-dealer and a wholly-owned subsidiary of LBHI¹⁷ began when LBI was incorporated under Delaware law on January 21, 1965 under the leadership of Robert Lehman. Robert, the son of one of the founding Lehman brothers, was the last family member to run Lehman, and he brought great changes during the course of his 44-year tenure.¹⁸

14. See Trustee's Third Interim Report.

15. Attached as **Exhibit C** hereto is a chronology of Lehman's more recent history, with a particular focus on rapidly evolving developments in the firm's final days.

16. See, e.g., KEN AULETTA, *GREED AND GLORY ON WALL STREET: THE FALL OF THE HOUSE OF LEHMAN* (The Overlook Press 2001) (1986); LAWRENCE G. McDONALD & PATRICK ROBINSON, *A COLOSSAL FAILURE OF COMMON SENSE: THE INSIDE STORY OF THE COLLAPSE OF LEHMAN BROTHERS* (2009); JOSEPH TIBMAN, *THE MURDER OF LEHMAN BROTHERS: AN INSIDER'S LOOK AT THE GLOBAL MELTDOWN* (2009); ANDREW ROSS SORKIN, *TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM — AND THEMSELVES* (2009); MARK T. WILLIAMS, *UNCONTROLLED RISK: THE LESSONS OF LEHMAN BROTHERS AND HOW SYSTEMIC RISK CAN STILL BRING DOWN THE WORLD FINANCIAL SYSTEM* (2010); VICKY WARD, *THE DEVIL'S CASINO: FRIENDSHIP, BETRAYAL, AND THE HIGH STAKES GAMES PLAYED INSIDE LEHMAN BROTHERS* (2010); HENRY M. PAULSON, JR., *ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM* (2010).

17. Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 1 (March 31, 1994).

18. Robert Lehman assumed principal responsibility for the Lehman Brothers partnership in 1925 and led the firm through its golden age until his death in 1969. See Steve Fishman, *Burning Down His House*, NEW YORK, Dec.

B. LBI 1965-1994

27. Under Robert Lehman’s guidance, and as the result of the Banking Act of 1933 (Glass-Steagall Act), Lehman cut its ties to commercial banking and instead focused on investment banking.¹⁹ Then, beginning in the 1960s, the firm expanded its traditional investment banking business towards new financial instruments, such as derivatives and asset-backed securities, in order to meet the increasing demands of clients for these new products, and to become a full-service institution that could compete with the top investment banks.²⁰ Beginning in the 1970s, deregulation of the financial industry led to the expansion of financial products and financing mechanisms.²¹

28. By July 1983, Lehman was more profitable than it had ever been, with capital of nearly \$250 million and equity of \$175 million.²² But the firm then underwent a period of decline, with infighting between the firm’s trading and investment banking factions causing disruptions.²³ By the fall of 1983, the firm was undercapitalized and began looking for buyers. In 1984, Lehman Brothers was acquired by Shearson/American Express (“AmEx”) with

(Footnote continued from prior page)

8, 2008, at 34; Harvard Business School, History of Lehman Brothers, <http://www.library.hbs.edu/hc/lehman/history.html>.

19. AULETTA, *supra* note 16, at 30-1.

20. A confidential report commissioned by Lehman’s Board of Directors in 1973 highlighted Lehman’s weaknesses and suggested that in order to meet the competitive demands of the marketplace, the firm would have to expand the financial services that it offered. *See id.* at 41-4; *see also* General Accounting Office, Risk-Based Capital: Regulatory and Industry Approaches to Capital and Risk, GAO/GGD 98-153, 35-7 (July 1998) (noting that changes in the financial services industry, including an expansion of financial products, also increased competition, which spurred financial firms to diversify and increasingly operate in what were once separate banking, insurance and securities sectors).

21. SAM Y. CROSS, ALL ABOUT...THE FOREIGN EXCHANGE MARKET IN THE UNITED STATES 3-4 (1998).

22. AULETTA, *supra* note 16, at 3-4.

23. Robert J. Cole, *Shearson to Pay \$360 Million to Acquire Lehman Brothers*, N.Y. TIMES, Apr. 11, 1984, at A1.

an agreement that the new firm would be called Shearson Lehman/American Express, preserving the 134-year-old Lehman name. After AmEx divested itself of Lehman in 1994, LBI continued to operate as a broker-dealer, initially concentrating on the bond business.²⁴

C. LBI 1994-2008 — A Period Of Record Growth And Profits — And Increasing Risk

29. After the AmEx spin off, Lehman’s CEO Richard S. Fuld, Jr. became the leader of what was then primarily a fledgling domestic bond firm that focused almost exclusively on fixed income.²⁵ The years under AmEx had considerably weakened Lehman, and when it emerged as an independent entity in 1994, it had only 9,000 employees and \$75 million in earnings.²⁶ Under Fuld, by 2007, Lehman grew into a diversified global firm with 28,000 employees and over \$4 billion in earnings, approximately \$22.5 billion in shareholders’ equity, and net revenues of \$19.3 billion.²⁷

30. Lehman cut costs and expanded its business activities during Fuld’s tenure. This expansion included the acquisition of Neuberger Berman in October 2003, giving LBI a brokerage business (called the PAM business), which included high net worth individuals

24. See Jay Mathews, *American Express to Spin Off Lehman; Investment Bank to Go to Shareholders, Employees in Tax-Free Deal*, WASH. POST, Jan. 25, 1994, at D2; Leah Nathans Spiro, *Lehman Brothers: Free at Last*, BUS. WK., May 22, 1995, at 112.

25. Fuld came to Lehman as an intern in 1966, and joined the firm full time as a commercial paper trader in 1969 while earning his business degree at night. He became CEO in 1994 after Lehman Brothers separated from AmEx. *Causes and Effects of the Lehman Brothers Bankruptcy: Hearing Before the H. Comm. on Oversight and Government Reform*, 110th Cong. 119-20 (2008) (statement of Richard S. Fuld, Jr., Chairman and Chief Executive Officer, LBHI); *see also* Written Statement of Richard S. Fuld, Jr. Before the H. Comm. on Oversight and Government Reform, 110th Cong. 3 (2008), *available at* http://oversight.house.gov/index.php?option=com_content&view=article&id=4692:committee-holds-hearing-on-the-causes-and-effects-of-the-lehman-brothers-bankruptcy&catid=42:hearings&Itemid=2 (“Fuld Written Statement”); Fishman, *supra* note 18, at 31 (noting that Lehman emerged from the spin-off as “a small bond shop that few thought would survive”).

26. Fuld Written Statement, *supra* note 25, at 3.

27. *Lehman Brothers Hearing*, *supra* note 25 (statement of Richard S. Fuld Jr.), at 120; Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 14, 29 (Jan. 29, 2008).

and institutions. Lehman also expanded by means of fixed income derivative products created and distributed through LBI's subsidiaries Lehman Brothers Special Financing, Inc. ("LBSF"), and the separately capitalized Lehman Brothers Financial Products, Inc. ("LBFP"), as well as through significant real estate investments.²⁸ The equity derivatives products business was conducted through Lehman Brothers Finance S.A. ("LBF").²⁹

31. Lehman Brothers Commercial Paper, Inc. ("LCPI") was an LBI subsidiary that effectively abandoned its traditional commercial paper business and concentrated instead on purchasing mortgage loans for securitization and financing acquisitions.³⁰ LB I Group, a private equity subsidiary of LBI, engaged in strategic, non-real estate investments, generally long-term in nature. These entities expanded the scope of financial products and transactions from those previously conducted by Lehman. This expansion included involvement in interest rate swaps, interest rate and equity derivatives, mortgage-backed securities, currency derivatives, credit default swaps, total return swaps, collateralized debt obligations (including structured finance, collateralized debt obligations and corporate-backed synthetic collateralized debt obligations) and municipal bonds and derivatives. Recent history has shown some of these transactions to be far more risky than the typical bond, securities, and commercial paper transactions that had historically been the focus of Lehman's business.³¹ Thus, the growth and apparent success of

28. See Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 36, 45, 47 (Feb. 28, 1996) (noting that the use of derivative financial instruments expanded significantly over the past decade).

29. See *id.* at 47.

30. See Lehman Bros. Company Overview: First Quarter 2008, at 3 [LBI_PIR_000105].

31. See WILLIAMS, *supra* note 16, at 108 (regarding Lehman in the 90s, "Lehman's antiquated financial reporting infrastructure could not measure the more sophisticated risks it was taking. No longer did Lehman just have plain vanilla U.S. Treasury and corporate bond risk, which was the world Fuld understood. Lehman was now subject to non-linear risks that behaved in a less predictable fashion. These less predictable risks took on fancy

Lehman was achieved at the cost of increasing risk, the full extent of which became apparent with the loss in value of real estate investments and mortgage-backed securities.

D. The Business Of The Modern Broker-Dealer

32. By 2008, Lehman was operating around the world as a major investment bank. LBI was a registered broker-dealer in the United States and a wholly-owned subsidiary of LBHI. LBI was also a primary dealer in U.S. government securities and bought, sold and financed government securities directly with the FRBNY.

33. In the last years of its existence, Lehman's principal activities were to serve institutional, corporate, government and high net worth individual clients and customers throughout the world. Lehman's activities split into five divisions: Investment Banking, Fixed Income, Equities, Mortgage Capital and Investment Management. The Investment Management Division ("IMD") consisted of the Asset Management, Private Equity and PIM businesses. The Asset Management business generated fee-based revenue from products and services for institutional and individual clients through affiliates Neuberger Berman and Lehman Brothers Asset Management LLC ("LBAM") and included the PAM range of customer accounts. The Private Equity business operated in merchant banking, venture capital, real estate, credit related, fund of funds, and infrastructure to provide risk-adjusted returns to investors. PIM worked with high net worth individuals, middle market institutions and corporations and provided a wide variety of services including investment advice, capital markets expertise, tax and estate

(Footnote continued from prior page)

names such as *inverse floaters*, *reset options*, and *knock-out options*. Derivatives entailed the use of leverage that added to price swings. Lehman's increased trading of mortgage-based securities (MBS), asset-backed securities (ABS), and over-the-counter (OTC) derivatives particularly drove the need for greater risk measurement and reporting sophistication." (emphasis in original); *see also Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals, Part I: Hearing Before the H. Comm. on Financial Services*, 111th Cong. 10-11 (2009) (statement of Gary Gensler, Chairman, CFTC) (proposing capital standards and margin requirements to help lower risk).

planning, and in some cases corporate treasury services (“CTS”) as part of a PIM account relationship.

34. In addition to the PIM and PAM accounts, LBI operated a prime brokerage business for many hedge funds (in some of which other Lehman entities had a minority interest). LBI also cleared transactions for the hedge fund business of its European affiliate, LBIE, a U.K. broker-dealer, as well as for the Neuberger Berman PAM accounts. LBI also custodied securities or held securities as collateral for transactions with counterparties undertaken by other Lehman entities and cleared proprietary trades for Lehman Brothers OTC Derivatives Inc. (“LOT”), which, as a “broker-dealer light,” could report on an adjusted risk basis for capital reporting purposes. LBI also maintained account ranges for affiliates, which were generally subordinated. Other non-PIM and non-PAM account ranges comprised the largely non-actively traded accounts of institutional and corporate clients, which Lehman cultivated for M&A and financing work, and some CTS accounts not considered part of the PIM business. Still other ranges encompassed accounts for non-traditional trading such as “to be announced” trades on mortgage related securities (“TBAs”) and Foreign Exchange trades (“F/X”). As described later in this Report, at the time of Trustee’s appointment the nature and magnitude of most of the non-PIM, non-PAM accounts were unknown.

E. Regulatory Oversight

35. In the ordinary course, a broker-dealer is a fragile entity dependent on its ability to borrow in order to fund its operations; the fully-paid property it holds for customers has to be segregated and not used for proprietary purposes, and it must retain in addition a net capital

cushion.³² Many of its proprietary assets are pledged to third parties to finance its proprietary transactions and clearing bank collateral requirements, as well as some margin lending. In 2008, when funds from a primary source of LBI's funding — the parent company, LBHI — started to dry up and eventually disappeared, the pressure on LBI's third-party funding sources, already under strain, only increased and made liquidation inevitable. However, until that time — and aside from losses at its subsidiaries — LBI's status as a regulated broker-dealer appeared to comply with applicable Financial Responsibility Rules, and the customer property it was required to hold was to a large extent intact.

1. The Financial Responsibility Rules

36. As a broker-dealer, LBI was regulated by the SEC, individual state securities authorities, as well as self-regulatory organizations such as the Municipal Securities Rulemaking Board and the New York Stock Exchange (“NYSE”), later consolidated into the Financial Industry Regulatory Authority (“FINRA”).³³ In addition, LBI was a member of SIPC³⁴ and, as a registered futures commission merchant, was also subject to the regulation of the CFTC.

37. A broker-dealer typically operates with two separate pools of money: clients' money, and its own money that is used for proprietary investments. The “Financial Responsibility Rules” of the Securities Exchange Act of 1934, principally among them “SEC

32. *See* SEC Rules and Regulations under Securities Exchange Act 1934, 17 C.F.R. § 240.15c3-3 (2010) (requiring segregation of fully paid customer securities); 17 C.F.R. § 240.8c-1 (restricting hypothecation of customer securities).

33. *See* Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 13 (March 31, 1994) (noting that the SEC had designated the NYSE as LBI's primary regulator). In 2007, the SEC designated FINRA as LBI's primary regulator. *See* Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 10-11 (Jan. 29, 2008).

34. SIPC § 78ccc(a)(2) (requiring virtually all registered broker-dealers to become a member of the SIPC).

Rule 15c3-3” (17 C.F.R. § 240.15c3-3, known as the “Customer Protection Rule”), require broker-dealers like LBI to segregate and protect customer property.³⁵ The intent of the Customer Protection Rule is that fully paid-for customer property will be largely available if a broker-dealer is liquidated either through a claims process or an account transfer process. Accordingly, in contrast to margin securities, LBI could not use fully-paid customer securities or excess customer margin to finance its own operational or proprietary activities because these categories of customer property had to be segregated for customers.³⁶

38. While SEC Rule 15c3-3 prohibits a broker-dealer from using fully paid customer securities and excess margin to finance its own activities, customers often borrow money from brokerages to buy securities in what is known as margin lending. SEC Rule 15c3-3 requires that the firm maintain possession and control of fully paid-for customer securities and excess margin, and maintain cash or qualifying securities in an account for the exclusive benefit of customers. If a customer borrowed money to purchase securities, then LBI could re-pledge those margin securities (up to a prescribed amount) because they were not yet considered fully paid-for. LBI was able to lend such securities to a third-party and obtain cash in return to finance trading inventory positions, settle its accounts, or meet customers’ needs.

39. The net capital rule requires the broker-dealer to maintain a cushion of capital net of obligations and haircuts on asset valuations to ensure the broker-dealer’s viability and wherewithal to be liquidated or transferred.³⁷ In addition, in LBI’s case under the

35. See Amendments to Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 34-55431, 72 Fed. Reg. 12862 (Mar. 19, 2007).

36. 17 C.F.R. § 240.15c3-3; see Michael Jamroz, *The Customer Protection Rule*, 57 BUS. LAW. 1069 (2002).

37. See 17 C.F.R. § 240.15c3-1.

Consolidated Supervised Entities (“CSE”) program described below, its minimum net capital had to be at least \$500 million and its tentative net capital at least \$1 billion. Generally, LBI’s compliance with its net capital, customer segregation and other regulatory requirements was closely monitored not only internally but also by FINRA and the SEC, and appeared to be largely satisfactory, until the last months of its existence when both internal and external operational factors compromised transparency into LBI’s actual financial condition.³⁸

2. The CSE program

40. In addition to the traditional regulation of LBI as a securities broker-dealer under the SEC Financial Responsibility Rules, LBI and LBHI entered the CSE program in December 2005. The SEC had implemented the CSE program in June 2004 as a way for global investment bank conglomerates lacking a supervisor under law to submit voluntarily to U.S. regulation.³⁹ Under the CSE program, a broker-dealer that maintained “certain minimum levels for net capital and tentative net capital [was eligible to] apply for a conditional exemption from the application of the standard net capital calculation.”⁴⁰ As a condition to granting the exemption, the broker-dealer’s ultimate holding company was also required to consent to group-wide SEC “supervision related to the financial stability of the broker-dealer.”⁴¹ Under the alternative capital computation method, the SEC permitted broker-dealers to calculate certain

38. *See* Motion for Order Approving Trustee’s Allocation of Property of the Estate at 36-53 (LBI Docket No. 1866); Lehman Brothers Holdings Inc., Quarterly Report (Form 10-Q), at 36 (Apr. 9, 2008).

39. Press Release, U.S. Sec. & Exch. Comm’n, Chairman Cox Announces End of Consolidated Supervised Entities Program (Sept. 26, 2008), *available at* <http://www.sec.gov/news/press/2008/2008-230.htm>.

40. Letter from Kathleen E. Wannisky, Managing Associate General Counsel, United States General Accounting Office, to The Honorable Richard C. Shelby, Chairman, Committee on Banking, Housing, and Urban Affairs, United States Senate, *et al.* (June 25, 2004) (GAO-04-896R) (“Alternative Net Capital Report”).

41. *Id.*

market and credit risk capital charges using internal mathematical models.⁴² It was anticipated that broker-dealers enrolling as CSEs would have “lower deductions from net capital for market and credit risk.”⁴³ As a condition to its use of the alternative method of computing net capital, the broker-dealer was also required (under the second part of the rule) to provide the SEC with an undertaking in which the ultimate holding company agrees to consolidated, group-wide supervision by the SEC.⁴⁴ A registered holding company would thereafter permit the SEC to supervise it and its affiliates on a group-wide basis.

41. The rules also established separate regulatory requirements for Supervised Investment Bank Holding Companies (“SIBHCs”). Commission supervision of an SIBHC – which Lehman was not – included recordkeeping, reporting and examination requirements pursuant to SEC Rule 15c3-4. Furthermore, the SIBHC was required to comply with rules regarding its group-wide internal risk management control system and provide the Commission with consolidated computations of allowable capital and risk allowances or other capital assessment.

42. In short, if a broker-dealer wanted to use the alternative method for computing net capital, its holding company had to consent to increased reporting on both capital and risk issues. The most obvious penalty was that the SEC could deny the broker-dealer the ability to use the alternative calculations (which would be more expensive for the firm). LBI,

42. *Commission Announcements, Broker-Dealer and Affiliate Supervision on a Consolidated Basis*, SEC News Digest, 2-3 (June 9, 2004), available at <http://www.sec.gov/news/digest/dig060904.txt>.

43. Alternative Net Capital Report at 1.

44. 17 C.F.R. § 240.15c3-1a(7).

through its Legal and Regulatory Control group, regularly communicated with the SEC regarding the details of calculations made under the alternative method.

43. If the holding company did not otherwise have a principal regulator, the CSE rules permitted the SEC to impose additional conditions on the broker-dealer or the holding company as “necessary or appropriate in the public interest or for the protection of investors.”⁴⁵

These conditions might include, for example,

restricting the broker’s or dealer’s business on a product-specific, category-specific, or general basis; submitting to the Commission a plan to increase the broker’s or dealer’s net capital or tentative net capital; filing more frequent reports with the Commission; modifying the broker’s or dealer’s internal risk management control procedures; or computing the broker-dealer’s deductions for market and credit risk in accordance with § 240.15c3-1(c)(2)(vi), (c)(2)(vii), and (c)(2)(iv), as appropriate.⁴⁶

In practice, the SEC chiefly relied on its power to require Lehman to “file more frequent reports or to modify its group-wide internal risk management control procedures” as a condition to remain in the CSE program.⁴⁷

44. Under the CSE program, a small team from the SEC’s Division of Trading and Markets was charged with monitoring Lehman’s risk management function. One team member was assigned to monitor each of the following areas at Lehman: market risk, liquidity risk, and credit risk. This team reported to an Assistant Director in the Division of Trading and Markets. Other teams from FINRA and the CFTC, in conjunction with the SEC, intensified their monitoring and examination of LBI’s and Neuberger Berman’s compliance with the SEC

45. SEC Rules and Regulations under Securities Exchange Act 1934, 17 C.F.R. § 240.15c3-1e(a)(1)(ix)(D) (Appendix E) (2010).

46. 17 C.F.R. § 240.15c3-1e(e).

47. *Id.*

Financial Responsibility Rules and the brokerage businesses' financial condition generally, insisting on weekly financial and profit and loss statements. Many details of the monitoring of the enterprise as a whole are detailed in the Examiner's Report and need not be repeated here.⁴⁸

45. As the Trustee's review of the LBI experience shows, once an entity the size and scope of Lehman as a whole has already become highly leveraged and enmeshed in risky transactions, the CSE program gave the SEC seemingly ample but in practice imperfect and unwieldy tools — and limited resources — for effecting immediate change. Publicizing a failure to pass a hypothetical financial stress test would cause the very collapse the program was designed to prevent. Moreover, the SEC was the monitor, not the manager, of the business; as the Examiner's Report and other sources have documented, even when Lehman had risk controls in place, management was allowed to retain the business judgment to override them, as in the Archstone transaction.⁴⁹

46. Whether earlier adoption of the CSE program accompanied by more resources and more forceful intervention (for example, by requiring compliance with internal risk management guidelines shared with regulators) might have saved Lehman or mitigated the impact that a broader failure had on the broker-dealer is a moot question. Probably only forceful intervention by late 2006 or early 2007, or greater separation of the broker-dealer from entities engaging in risky proprietary transactions, would have prevented a salvage operation for the broker-dealer. Such radical steps would have meant a much-reduced Lehman and would have

48. *See* Examiner's Report at 1484-92.

49. As part of a joint venture, on May 29, 2007 Lehman and Tishman Speyer agreed to acquire Archstone, a publicly traded real estate investment trust ("REIT"). The transaction closed in October 2007, with Lehman funding \$5.4 billion of the \$23.6 billion purchase price, making Archstone Lehman's largest commercial real estate investment. *See* Examiner's Report at 112, 356.

been stoutly resisted by management and the industry as a whole. In addition, Lehman was victimized in large part by the same systemic crisis of confidence and inability to obtain financing that caused bailouts or buyouts of peer firms to avoid bankruptcy. Systemic market failure of this magnitude was not contemplated by the CSE tests, which focused primarily on the ability of a firm to survive a severe (but not unprecedented) downturn similar to various other historic downturns. An internal April 2008 stress test, reported on by the Examiner, showed that the broker-dealers, LBI and LBIE, were predicted to lose immediately over \$31 billion of repo financing between them and almost twice that much after four weeks. Yet, LBI alone incurred a loss equal to or greater than those joint estimates between the end of August and the filing date of September 19, 2008.

IV. KEY FEATURES OF LBI'S BUSINESS AND WHAT HAPPENED TO THEM BY THE TIME OF THE LIQUIDATION

47. During the period that regulators from the FRBNY, SEC, FINRA and the CFTC were present at LBI, there were relatively few overt signs of non-compliance with technical regulatory requirements. In this section, we try to explain what did happen to the U.S. broker-dealer, LBI, once the crisis of confidence in Lehman as a whole reached its tipping point.

48. As the Examiner has reported, just months prior to its bankruptcy filing, LBI's parent company, LBHI, recorded record revenues and record earnings in excess of \$4 billion for its fiscal year ending November 30, 2007.⁵⁰ During the same period, LBI also reported a seemingly sound financial condition.⁵¹ This Report describes the nature of some of

50. Examiner's Report at 2. The Examiner noted that total revenues were \$60 billion though the more meaningful numbers were probably the less dramatic net revenue of \$19 billion. Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 29 (Jan. 29, 2008).

51. This analysis does not purport to be a solvency analysis for purposes of avoidance actions or other legal issues.

LBI's businesses and assets and what happened to them in the weeks and months leading to its liquidation, using as a reference point, the balance sheet included as part of LBI's May 31, 2008 Financial and Operational Combined Uniform Single ("FOCUS") Report.⁵²

49. Unsurprisingly, the Trustee's analysis of LBI's finances demonstrates that while LBI itself continued to be in compliance with the regulatory requirements for a US-broker-dealer.⁵³ LBI's overall financial condition deteriorated over the last three and a half months of its existence. Much of this decline was attributable to losses at its subsidiaries, which had engaged in riskier investments. There were significant and well-published causes for concern with respect to LBHI during the spring and summer of 2008, and LBI was dependent on LBHI's viability (and the market's confidence in it). Whether or not LBI technically could be considered insolvent at a much earlier time — a question that may be subject to litigation and on which this Report therefore takes no position — it was not until relatively late in the game that LBI's financial position deteriorated to the point where liquidation or transfer to another broker was the only remaining option to protect customers. Tangible negative effects on LBI from the crisis in confidence affecting Lehman as a whole rendered LBI unable to obtain adequate financing on an unsecured or even secured basis, caused the departure of customers, and spurred an increase in failed transactions and additional demands for collateral by clearing banks and others.

52. A FOCUS report is a periodic regulatory report filed by broker-dealers with the SEC that contains detailed information about a firm's financial and operational status, such as credit and debit balances and computation of net capital. LBI filed FOCUS reports on a monthly basis, the last of which was filed on August 25, 2008. *See* Lehman Brothers Inc., FOCUS Filing (Form X-17A-5) (Aug. 25, 2008); 17 C.F.R. § 240.17a-5 [LBI_PIR_000097].

53. *See, e.g.*, Draft of Lehman Brothers Inc., FOCUS Filing (Form X-17A-5) (Aug. 31, 2008) (on file with the Trustee). The draft was never filed with the SEC. [LBI_PIR_000067].

A. What Happened By The Time Of The Liquidation

50. May 31, 2008 was the date of the last issued public financial statement that included LBI. LBI and its subsidiaries also separately issued annual unaudited Statements of Financial Condition in compliance with SEC Rule 17a-5. Data from these May 31, 2008 reports can be compared to data from the draft August 31, 2008 FOCUS report (which was prepared but not filed with FINRA).⁵⁴ This period was the final three months in which LBI's internal controls and infrastructure operated under a "normal" environment that allowed for the creation of financial statements prepared consistently with historical financial statements.

51. This analysis shows that the financial condition of LBI deteriorated following May 31, 2008 up to the events of September 2008. The rumored, and later actual, insolvency filings of LBHI and LBIE had the effect of ending market and counterparty confidence in the viability of LBI and accelerating its deterioration. Essentially, in this period, a tremendous strain on LBI's cash resources resulted from:

- An inability to obtain financing on either a secured or unsecured basis from third parties, LBHI or Lehman affiliates,
- Transfers of some customer and PBAs,
- Increased demands for collateral or additional deposits from banks, clearing organizations and other parties, including its principal clearing banks, and
- An increase in failed transactions.⁵⁵

54. Lehman Brothers Inc., FOCUS Filing (SEC Form X-17A-5) (Aug. 25, 2008) [LBI_PIR_000097].

55. Failed transactions include both fail-to-receive and fail-to-deliver. A fail-to-receive occurs when a broker-dealer purchasing securities does not receive delivery from the selling broker-dealer on the settlement date. A fail-to-deliver occurs when a broker-dealer selling securities does not deliver them to the purchasing broker-dealer on the settlement date.

52. Apart from the effect on regulatory capital, the combination of these factors had the spiraling effect of reducing financing capacity and available cash (and assets available to be pledged for cash), so that normal operations could no longer be continued. By September 16, 2008, the FRBNY had to finance the operations of LBI, as counterparties were unwilling to undertake the risk of financing LBI during the wind down of its activities. In addition, as discussed elsewhere in detail, certain clearing exchanges took unilateral actions that resulted in hundreds of millions of dollars in reductions of or restrictions on the use of LBI's available assets, further contributing to LBI's liquidity problem.⁵⁶

1. Inability to obtain financing from third parties and affiliates

53. LBI used secured borrowing and lending transactions to finance inventory positions, obtain securities for settlement and meet clients' needs. LBI's inventory positions were primarily liquid assets (as interpolated from LBI's FOCUS filings). Consistent with its policy, most of LBI's funding was done on a secured basis. LBI assets at May 31, 2008 and August 31, 2008 primarily were made up of reverse repos, stock borrow agreements and financial instruments owned. These transactions represented 94.1% of assets at May 31 and 92.4% at August 31.

54. LBI's repos and stock borrows began to decline in the summer, as set forth in the following chart:

56. See *infra* Section IV.A.3.c.

(in millions)	5/31/08	8/31/08	9/19/08
Repurchase agreements – affiliates	\$ 63,982	\$ 43,427	\$11,132
Repurchase agreements – total	\$141,177	\$143,473	\$80,112
Securities loans – affiliates	\$ 81,174	\$ 61,942	\$41,032
Securities loans – total	\$ 87,666	\$ 68,162	\$41,777
Total repos and securities loans	\$228,843	\$211,635	\$121,889
Affiliate Percentage	63%	50%	43%

55. During September 2008, access to the financing markets became even more difficult, both with affiliates and third parties. As Lehman's condition became more precarious, third parties began decreasing their exposure to the Lehman entities, including LBI. Repo financing continued to decline significantly to the point that tri-party repo transactions decreased from approximately \$80 billion in May 2008 to less than \$650 million on September 19, 2008, according to LBI's records. LBI's access to the bonds borrowed market also decreased, putting additional strains on financing and the quality and variety of collateral LBI could offer to its repo counterparties. Another result of decreased access to the bonds borrowed market was that LBI, since it could no longer borrow bonds to cover shorts, had to use more of the bonds already in inventory to cover firm short positions. In order to obtain the collateral, LBI entered into reverse repo transactions which, though largely a wash for accounting and regulatory purposes where collateral values are sufficient, depleted its cash reserves.

56. Further constraints on LBI's liquidity arose from the volume and dollar amount of failed foreign currency transactions, and the failure of counterparties to return margin posted by LBI as LBI met its performance obligations. The result of these actions reduced available cash to LBI and its overall liquidity. On September 19, 2008, there were over

2,350 non-receipts as counterparties failed to perform on their legs of foreign currency contracts, and, as reported at the sale hearing, virtually no proprietary cash available to LBI.

57. The Lehman entities were under enormous market pressure as the press and counterparties demanded more and more evidence of their financial stability. The rumors about a potential sale of Lehman to Bank of America and then to Barclays would stabilize and then de-stabilize Lehman's position. As LBHI, LBIE, and the other affiliates approached September 12, 2008, their last business day of operation, the ability to obtain financing was more and more challenging, especially as demands for collateral increased. Once LBHI and LBIE's insolvency proceedings commenced on September 15, 2008, LBI's financing options ran out. The FRBNY had to step in with a \$45 billion repo facility that was used to finance the operations of LBI as counterparties were unwilling to undertake the risk of financing LBI during the wind down of its activities.

2. Customer relationships

58. During the period leading up to September 2008, the number, activity and balances of customer relationships indicated volatility in customer transactions with LBI as would be expected given the state of the U.S. markets.⁵⁷ For example, free credit balances⁵⁸ at hedge funds in Lehman as a whole declined by about \$3 billion between mid-March 2008 and the beginning of May following the Bear Stearns debacle. This loss of customers did not rival

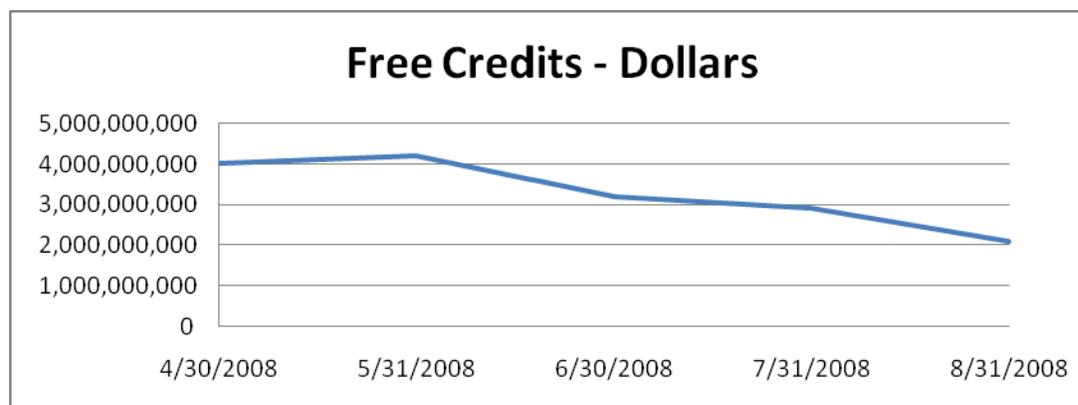
57. See, e.g., Eric Dash, *U.S. Gives Banks Urgent Warning to Solve Crisis*, N.Y. TIMES, Sept. 12, 2008, http://www.nytimes.com/2008/09/13/business/13rescue.html?_r=1&scp=1&sq=eric%20dash%20warning&st=cse (“[Government] [o]fficials detected a rising number of defections by Lehman's institutional customers to other firms, but nothing near the panic that caused Wall Street executives to bombard Mr. [Hank] Paulson with dire warnings about a Bear Stearns collapse in March.”).

58. Free credit balances are liabilities of a broker-dealer to customers, which liabilities are subject to immediate cash payment to customers on demand, whether resulting from sale of securities, dividends, interest, deposits or otherwise, excluding, however, funds in commodity accounts which are segregated in accordance with the Commodity Exchange Act or in a similar manner. 17 C.F.R. § 240.15c3-3(a)(3).

that which had occurred at Bear Stearns. It did, however, continue after the end of May, as reflected in the following metrics, and accelerated in September as many hedge funds began moving assets elsewhere in the wake of LBI's announcement of financial results.

(in millions)	5/31/08	8/31/08
Net payable to customers ⁵⁹	\$14,478	\$ 8,519
Amount required to be segregated for customer transaction under regulations:		
Securities Transactions ⁶⁰	\$ 4,013	\$ 4,933
Commodity Transactions	\$ 8,603	\$ 7,546
Free Credits in Customer Accounts	\$ 3,978	\$ 2,014

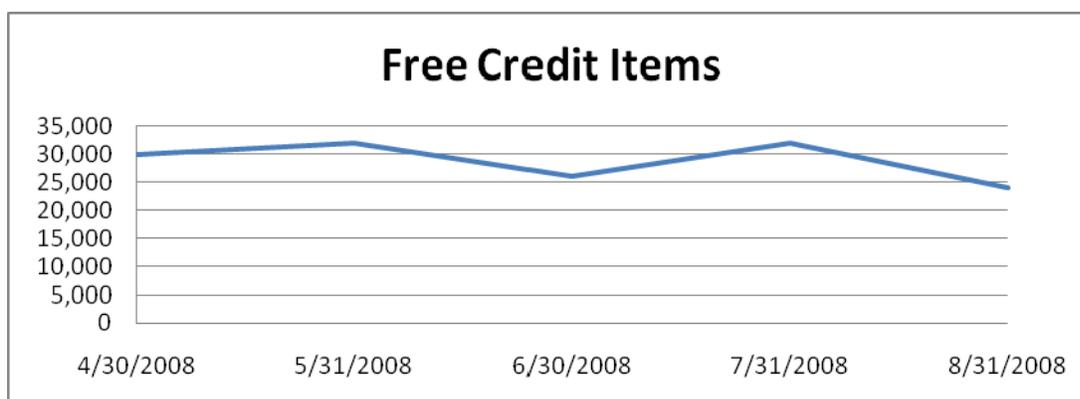
59. Legacy LBI regulatory reporting personnel maintained a report of total free credit balances in customer coded accounts across the various LBI clearance and settlement systems.⁶¹ The following charts show the trend in free credit balances and free credit items in LBI's customer-coded accounts.



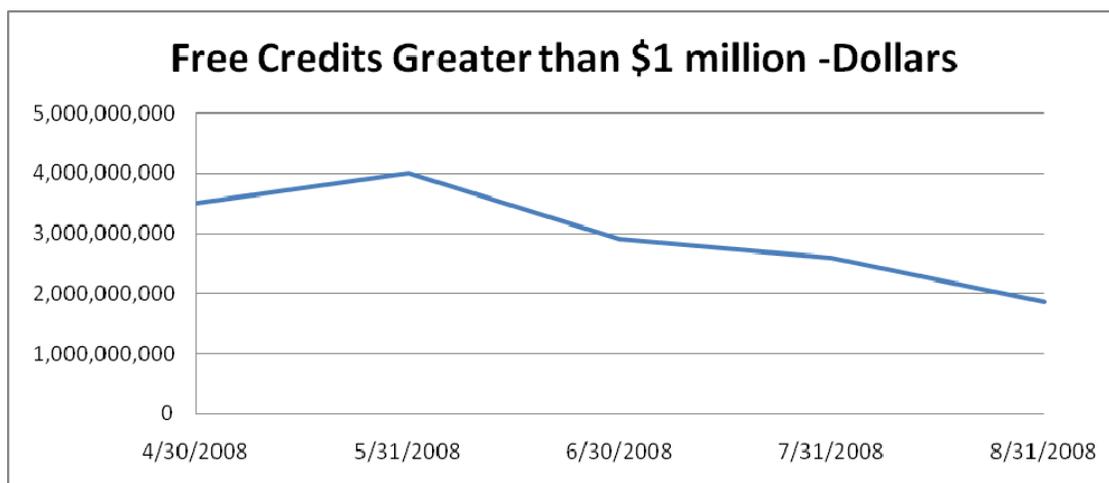
59. Net payable to customers is computed using the following line items on the FOCUS balance sheet: Payable to Customers plus Payable to Non-Customers minus Receivables from Customers minus Receivables from Non-Customers.

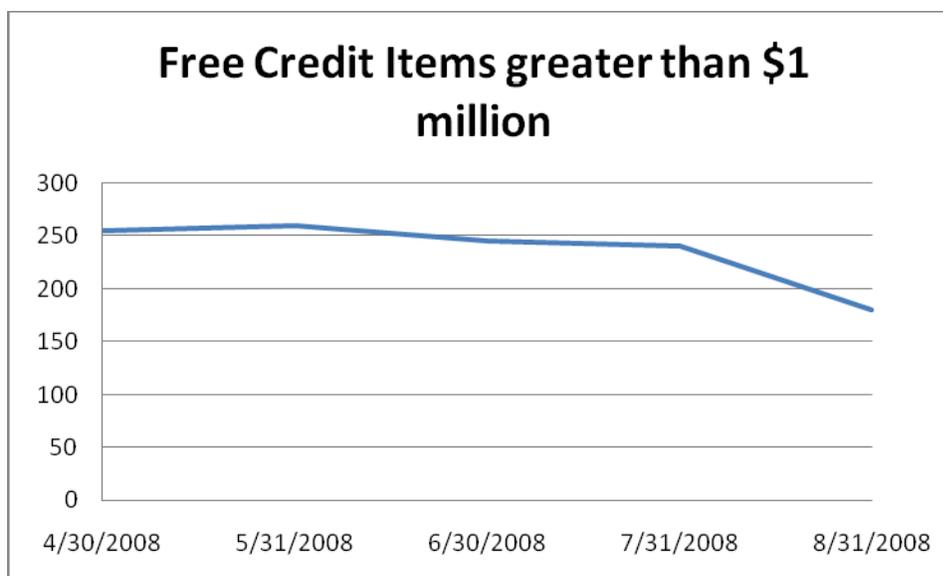
60. The requirement presented is the sum of the SEC Rule 15c3-3 and the Proprietary Accounts of Introducing Brokers (PAIB) Reserve Requirements.

61. From discussion with former LBI employees in Regulatory Reporting and Operations Control, there does not appear to have been a consistent process for determining free credit balances across the different clearance and settlement systems, or the reports/information used to prepare these reports.



60. The dollar value of LBI customer coded account free credit balances declined 62% between May 31 and September 19, 2008 (\$4,356 million to \$1,692 million), and the number of items (which generally correlate to accounts) declined 24% (31,538 to 24,124) over the same period. The decline in balances and accounts with a balance over \$1 million is even more pronounced: the dollar value of LBI customer coded account free credit balances declined 66% between May 31 and September 19, 2008 (\$3,941 million to \$1,352 million), and the number of items declined 40% (262 to 155) over the same period.





61. These figures indicate an increasing trend of customers removing their assets and accounts from LBI. By the filing date, a large number of Automated Customer Account Transfer Service (“ACATS”) transfers were being processed or in line to be processed for prime brokerage customers and others by DTCC, although some of these were later reversed as discussed in a later section of this Report.⁶² This trend was more pronounced for customers with larger free credit balances, whose demands for payment reduced LBI’s already-tightening liquidity.

62. Part of this impact related to LBI’s relationship with LBIE. LBIE was the principal European broker-dealer within the Lehman group. Prior to the commencement of the liquidation, LBI acted as clearing broker for LBIE and on behalf of underlying LBIE customers for transactions conducted in the US. LBIE’s last business day prior to the commencement of the administration of LBIE was September 12, 2008. LBI, however, did not commence its

62. See *infra* Section III.A.4.

liquidation proceeding until September 19, 2008, which is the relevant date for determining claims against LBI under SIPA.⁶³

63. Prior to the commencement of the administration, LBIE's customers, primarily prime broker customers, entered into significant trading or other activity. This activity included attempts to move whole accounts to new prime brokers, as well as other buy and sell transactions. In order to effectuate the transactions, some instructions were initiated multiple times, and attempts to move assets or accounts were processed in various ways. These last minute attempts to move the customer accounts not only further clouded the picture between LBIE and LBI but also indicated the urgency with which sophisticated customers were fleeing the Lehman enterprise in the last days.

3. Additional collateral requirements and clearing organization actions

64. LBI was required to post collateral with its clearing banks to secure risks the banks assumed in connection with clearing and settling LBI's proprietary and customer transactions. Through the summer of 2008 several key clearing banks increased their collateral requirements in response to perceived risks.

(a) JPMC

65. JPMorgan Chase ("JPMC") was LBI's principal clearing bank. It financed LBI's operations on a daily basis in amounts sometimes reaching over one hundred billion dollars. From July until September 2008, JPMC made a number of collateral demands to Lehman totaling approximately \$17 billion in cash and securities. The frequency and size of

63. SIPA §§ 78fff(a), 78lll(11); *see also* Memorandum Decision Granting Motion to Uphold Determination of Claim By SIPA Trustee (Bankr. S.D.N.Y. June 1, 2010) (LBI Docket 3330), *appeal docketed*, No. 10-cv-5740 (S.D.N.Y. June 28, 2010).

these demands increased during Lehman's final weeks of operations. On September 9, 2008, JPMC requested that Lehman post \$5 billion of collateral with JPMC.

66. On September 9th and 10th, Lehman attempted to gather the requested \$5 billion of collateral but was only able to locate and deliver approximately \$3 billion in unencumbered collateral that was available for pledge to JPMC. JPMC then requested an additional \$5 billion of collateral on or around September 12. To satisfy this new demand for collateral, Lehman Treasury reviewed the entirety of the Lehman organization (across many Lehman affiliate entities) for unencumbered assets. On the morning of September 12, Lehman Treasury located \$2.7 billion in cash at LBI. This \$2.7 billion was sent to LBHI, and LBHI then pledged the cash along with an additional \$2.3 billion from other Lehman entities to JPMC. (The Trustee is investigating whether later cash entries from LBHI effectively returned an equivalent amount of cash to LBI.)

67. The overall impact of JPMC's demands on Lehman for additional security was a reduction in available collateral (cash or securities) on an intra-day basis, and further constraints on LBI's intraday liquidity and capital. These liquidity and capital concerns required continual monitoring and management in the daily operations of LBI's business.

68. In addition to demands for collateral, JPMC also tried to reduce its exposure to Lehman by requiring various amendments to the agreement governing the terms of clearance activity for LBI, as well as the supporting security agreements and guaranties. In the final weeks of August 2008, JPMC and Lehman negotiated and executed amendments to the Clearance Agreement between JPMC and LBI dated July 15, 2000, and executed a Security Agreement and Guaranty Agreement between JPMC and LBHI, dated August 26, 2008.

69. The August Amendment to the Clearance Agreement was intended to net JPMC's liability to all Lehman affiliates to which it provided clearance advances through LBI. Thus, the August Amendments and related Security Agreement and Guaranty Agreement granted JPMC a lien on assets of LBHI and certain affiliates that cleared trades through LBI at JPMC. In the first week in September 2008, JPMC demanded that LBI execute an additional amendment to the Clearance Agreement.

70. In contrast to the August 2008 process for negotiating the amendment, the September amendment was executed on an expedited time frame, with virtually no negotiation of terms or concessions by JPMC. LBI was forced to accept this amendment on JPMC's unfavorable terms or face the possibility JPMC would stop providing advances to unwind LBI's tri-party repurchase transactions, which were necessary to the financing and operation of LBI.

71. The September 9, 2008 Amendment to the Clearance Agreement (and related supporting documents) between LBI and JPMC amended JPMC's security interest in LBI's property so that JPMC's lien on assets in LBI's clearance accounts purported to secure any and all indebtedness that LBI had to JPMC. (Previously JPMC's lien on assets in the clearance accounts only secured lending JPMC made pursuant to the clearance agreement, and not other LBI indebtedness.)

(b) Citibank

72. Citibank ("Citi") was Lehman's designated settlement member on the Continuous Linked Settlement ("CLS") system, and LBI was the primary Lehman entity dealing with Citi with respect to CLS transactions. Citi settled transactions sometimes approaching twenty billion dollars a day. LBI deposited \$1 billion at Citi late in the day on September 15, 2008 for the continuation of CLS services in accordance with an agreement between Citi and LBI signed that day. Although other Lehman entities were also engaged in CLS activity early in

the week, by Wednesday September 17, Citi was continuing CLS settlements only for LBI. LBI did not make certain payments to Citi that week for CLS activity, and Citi purported to set off the \$1 billion deposit against outstanding amounts allegedly owed to Citi for CLS activity and froze certain LBI bank accounts at Citi entities to cover the balance. The transactions with Citi are being investigated by the Trustee's conflicts counsel.

(c) Clearing organization actions

73. Other actions by U.S. exchanges reduced LBI's available cash or assets:

- The Options Clearing Corporation ("OCC") invoked its exchange rules as a basis to refuse to release over \$400 million of computed excess margin on September 19, 2008.
- The CME Group Inc. ("CME") auctioned LBI and its affiliates' positions and transferred the margin posted by LBI and its affiliates for those positions. Along with LBI's proprietary positions, the CME transferred to the winning auction bidders more than \$450 million in equity to offset the net short option value of the positions, as well as more than \$1 billion in risk-related "concessions," representing nearly all of the performance bond ("margin") that LBI had posted with the CME's exchanges in connection with these positions.
- As of the filing date, LBI had over \$1.8 billion of cash and securities on deposit with DTCC and its subsidiaries in its participant fund, and an estimated \$500 billion worth of transactions in the pipeline at DTCC's various subsidiaries. While the deposit requirements fluctuated on a daily basis between May 2008 and September 2008 due to the change in trading volume and pending settlements, there was an overall significant increase in LBI's deposit requirements with DTCC and its subsidiaries, especially during the last two weeks prior to bankruptcy. For example, the requirement at the National Securities Clearing Corporation ("NSCC") increased from \$134 million on September 5, 2008 to \$709 million on September 19, 2008.
- In Europe and other countries around the world, the filing of LBIE, LBHI and other affiliates also affected LBI's relationships related to deposits and margin, as well as collateral at clearing organizations. For example, certain exchanges in London took action similar to the CME's and auctioned or closed out positions related to Lehman once LBIE filed for bankruptcy. LBI positions and collateral held through LBIE were swept up in this close-out process.

4. Increase in failed transactions

74. From the period May 31, 2008 through August 31, 2008, LBI's clearance and settlement activities operated within industry norms insofar as failed transactions were

concerned. The SEC and FINRA were physically present in LBI's regulatory reporting department to understand major fluctuations that would have a negative impact on LBI's capital or customer reserve deposit requirement.

75. In September 2008, the number of failed transactions began to rise markedly as counterparties became concerned about LBI's continuing operations and Lehman affiliates started filing for bankruptcy. These significant increases in failed transactions reduced LBI's available cash and increased the need for financing positions at the very time when borrowing capacity was contracting. As noted, this reduction included the failure of counterparties to failed foreign currency transactions to return margin LBI had posted.

76. The impact of the failed transactions insofar as LBIE is concerned was exacerbated by the difference of a week between LBIE's administration date and LBI's liquidation date. During this period, as the settlement period for securities transactions continued, significant activity occurred related to LBIE's September 12, 2008, pending trades, as reflected on LBI's books and records. As a result, the reconciliation of LBIE's omnibus claim with the Trustee involves a detailed analysis and reconciliation of multiple transactions in each of over 8,400 unique securities. Of these, approximately 90% had stock record movements between September 12, 2008 and September 19, 2008. There are over 95,000 "failed to receive from LBI" trades across approximately 4,600 unique securities, and an additional 105,000 "failed to deliver to LBI" trades across 5,200 unique securities. The majority of the securities underwent significant LBI stock record activity after September 12 and require detailed analysis in order to be fully reconciled. Further adding to the confusion was the fact that certain customers continued to access and in some cases cancel trades or enter other activity in their accounts through the Lehman computing system, LehmanLive.

77. A team of, at varying points, between 50 and 90 professionals working on behalf of the Trustee, in cooperation with the LBIE administrators' professionals, has been reconciling these tens of thousands of transactions. The ramifications of LBIE's cessation in payment for trades as of September 12, 2008, while LBI would still be operating and its systems would continue to process trades, were not fully anticipated at the time of LBHI's Chapter XI filing, and the consequences were not well understood by operations personnel at the time.

B. LBI's Business In Relation To Lehman's Corporate Structure And Some Of Its Ramifications

78. Lehman as a whole operated hundreds of separate corporations that engaged in intercompany transactions as well as transactions with third parties. LBI interacted with a number of these companies, some of which were direct or indirect subsidiaries, and others of which were affiliate or "sister" companies. For instance, LBI acted domestically as the "paymaster" for many U.S. operations of LBHI and other Lehman entities, meaning that accounts payable flowed through LBI bank accounts. (LBHI performed this function for many of the non-U.S. Lehman entities.) LBI also custodied domestic securities for other affiliates or to secure obligations or support transactions by clients of these affiliates and acted as a provider of certain operational and information services related to the brokerage business and custody of securities. LBI was in many cases the record employer and the source of payroll and employment benefits for Lehman employees who might perform services for the benefit of other Lehman entities. It also acted as market maker for LBHI's subordinated bonds.

79. As the Chapter XI Debtors have noted, however, "Lehman in most respects managed the Regulated Subsidiaries [such as LBI] separately from LBHI and the

Unregulated Subsidiaries.”⁶⁴ As a regulated broker-dealer, LBI had to operate as a separate entity and in accordance with rules that did not pertain to other Lehman entities. It could not as a practical matter loan money to subsidiaries and affiliates on an unsecured basis, for example. In profitable times, LBI did dividend some profits to its parent once or twice a year. Often some of these dividends derived from LBI profits were returned to LBI by LBHI on a subordinated basis meant to benefit LBI’s regulatory capital.

80. LBI entered into a variety of financial transactions with other broker-dealers, financial institutions, and investors, sometimes in conjunction with other Lehman affiliates. For example, LBI provided its services as a broker-dealer to Lehman entities seeking to make and clear trades in the U.S. In this role, LBI served as Neuberger Berman’s clearing broker pursuant to a May 2004 agreement.⁶⁵ LBI also acted as a clearing broker for U.S. securities transactions by overseas customers of LBIE (and vice versa) and also cleared proprietary trades for LOTC.

1. Transactions with or involving other Lehman entities

81. While the relationships between LBI and the other Lehman entities may have functioned well while the parties were financially healthy, LBI felt the adverse effect of them when LBHI and its separate affiliates commenced insolvency proceedings.

64. Debtors’ Motion Pursuant to Sections 105(a), 345(b), 363(b), 363(c) and 364(a) of the Bankruptcy Code and Bankruptcy Rules 6003 and 6004, (A) for Authorization to (i) Continue Using Existing Centralized Cash Management System, as Modified, (ii) Honor Certain Prepetition Obligations Related to the Use of the Cash Management System, and (iii) Maintain Existing Bank Accounts and Business Forms; (B) For an Extension of Time to Comply with Section 345(b) of the Bankruptcy Code, and (C) to Schedule a Final Hearing, at ¶ 11 (LBHI Docket No. 669).

65. See Trustee’s First Interim Report for the Period Sept. 19, 2008 through May 29, 2009 ¶ 13 (LBI Docket No. 1151), available at www.lehmantrustee.com (the “Trustee’s First Interim Report”). Neuberger Berman Inc., a leading asset management firm whose brand Lehman kept intact, was initially acquired in October 2003. See Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 8-9 (Feb. 26, 2004).

82. The ramifications of a series of transactions between separate entities when one or more of the parties is financially unstable are reflected in a September 12, 2008, email exchange among Lehman executives who considered the actions of counterparties as increasing the likelihood of default events. One executive noted the potential for defaults between LBI, LBHI and LBSF (an LBI subsidiary transferred to Lehman ALI as part of the payment-in-kind (“PIK”) note transaction on September 19): “...If we work on the assumption that in a disaster scenario [where banks fail] to fund clearing account[s] at LBI — then at the close of business on Monday [September 15, 2008] LBI will be in default on its overnight repo book and security lending book by failing to repay...” The executive noted the potential snowball effect as follows: “...if default by LBI becomes a default on a single material LBHI corporate indebtedness in excess of 100 million — that would cause a cascade into the LBSF swaps business — permitting the LBSF swap counterparties to liquidate immediately at the end of Monday.”⁶⁶

83. As described more fully below, LBI engaged in various transactions with its subsidiaries, though, as a practical matter, it was virtually impossible for it to make unsecured loans to them to cover losses. These transactions included repos, securities lending agreements, foreign exchange derivatives, and TBAs, some of which were part of LBI hedging strategies. Many of LBI’s subsidiaries and affiliates were organized with specific financial products or services in mind, and provided those products and services to multiple Lehman entities.

66. See E-mail dated Sept. 12, 2008 [LBI_PIR_000010].

(a) Repo agreements with affiliates and other entities

84. LBI, like other broker-dealers, relied on two means of financing its operations. First, LBI entered into repo agreements, a form of financing transaction through which it transferred securities to counterparties in exchange for cash and simultaneously agreed to reacquire the securities at a later date.⁶⁷ Repos are the principal means by which broker-dealers finance their inventory positions of U.S. Treasury, mortgage-backed, corporate, and money market securities, as well as their high grade sovereign debt. Repos enable broker-dealers to increase their liquidity by raising short-term cash at better interest rates than they could receive through traditional bank loans. They are an attractive option for high net worth investors considering short-term investments due to the flexibility of maturities — making repos an ideal place to place funds on a temporary basis (although at the risk which the SEC requires to be disclosed to counterparties for hold-in-custody repos, and which LBI generally disclosed to all repo counterparties, that they will not be considered customer transactions in a SIPA liquidation). Dealers may also enter into “reverse repos,” in which they borrow securities to either cover short positions or because of operational fails.

85. The second means of financing is by realizing profits from the spreads in repo rates, called a “matched book,” in which broker-dealers create liquidity in the repo market by borrowing and lending specific securities for specific periods of time based on their view of interest rate fluctuations. To profit from matched book repos, brokers create offsetting positions in repos and reverse repos using identical securities. LBI, and other broker-dealers, did this by executing reverse repos (in which they effectively borrow securities) with maturity dates and

67. Lehman Brothers, Repo Manual, 6 (Nov. 8, 2005) (unpublished internal manual) [LBI_PIR_000120].

interest rates which are different from those of the corresponding repos (in which they effectively lend securities) in order to profit from future shifts in interest rates between the mismatched maturities.

86. For short-term investments, a government securities dealer borrows from an investor using securities as collateral. These repos may have a fixed maturity date or will be open repos, that is, callable at any time. Rates are negotiated directly by the parties involved, but are generally lower than rates on collateralized loans made by New York banks.

87. One specific repo transaction used by LBI was the overnight repo, an arrangement through which securities dealers and banks finance inventories of Treasury bills, notes and bonds. The dealer or bank in turn transfers securities to an investor with a temporary surplus of cash, agreeing to reacquire them the next day. These financing transactions are settled with immediately available federal funds (funds held by banks at the Federal Reserve as part of their reserve requirements), usually at a rate below the federal funds rate charged by banks lending funds to each other. Although these transactions were often structured as “overnight” deals, it was common for broker-dealers to continue the repo for longer periods, with the agreement of the counterparty. If the collateral gained or lost value, however, the borrower or lender could demand additional cash or collateral to cover that change, or terminate the repo.

88. LBI allowed sophisticated clients, those with a minimum net worth of \$10 million and who were approved by LBI’s credit department, to engage in repos. Rates were determined by the product-specific repo market. LBI determined the details of these agreements using an internal credit risk management site that provided haircut grids, credit analyst coverage and credit limit information for financial trades.

89. Recognizing that repos are largely used as financing vehicles, SIPC has long taken the position that they are secured loans and do not qualify for customer treatment under SIPA. LBI's sales literature and the agreements governing repo transactions informed repo counterparties that SIPC has taken the position that they would not be protected under SIPA in the event of a liquidation proceeding.⁶⁸ Nevertheless, approximately 38 repo counterparties have objected to the Trustee's denial of their claims for SIPA customer treatment.

90. The collateral provided for LBI's repos consisted of Treasuries, agencies, and foreign government bonds, and asset-backed securities. Many of these repos were conducted with the Primary Dealer Credit Facility ("PDCF"), the discount window that the FRBNY had opened as Bear Stearns collapsed. LBI packaged securities, such as the "Freedom CLO" (Collateralized Loan Obligation), for transactions with the PDCF that it did not market in the general course of business. This collateral was illiquid and poorly rated. Because the government was willing to accept these CLOs as collateral (and assumed some risk that it was later eager to shed), LBI was able to obtain needed liquidity by including them in repos.

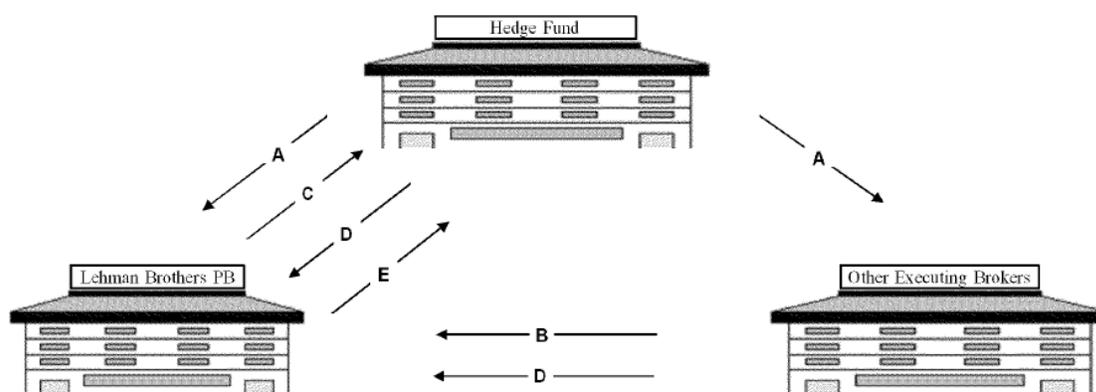
(b) Prime brokerage accounts

91. LBI's Prime Services — the "prime brokerage" business — worked with hedge funds, acting as the main point of contact at LBI for clearing trades, maintaining custody of securities, providing margin financing, lending stock to cover short sales, and providing cash

68. See SEC Rules and Regulations under Securities Exchange Act 1934, 17 CFR § 240.15c3-3(b)(4)(i)(C) (2010) ("a broker or dealer that retains custody of securities that are subject of a repurchase agreement between the broker or dealer and the counterparty shall . . . advise the counterparty in the repurchase agreement that [SIPC] has taken the position that the provisions of [SIPA] do not protect the counterparty with respect to the purchase agreement;"); *see, e.g.*, Client Stmt. For Gen. Motors Acceptance Corp. (July 2003), at 5 (noting that "securities lending and borrowing transactions and repurchase and reverse repurchase agreements may not be protected by SIPC").

and position reports.⁶⁹ LBI serviced hundreds of PBAs representing billions of dollars in value through its Prime Services unit.⁷⁰ These PBAs — primarily hedge funds, pension funds, institutional investors, university endowments and asset managers — controlled large pools of investment capital held on behalf of many retirees, employees, depositors, and investors. The business flow of PBAs functioned as follows:

Prime Brokerage Business Flow



- A) Fund executes trades with multiple brokers and informs its Prime Broker
- B) Executing brokers "give up" the trades to Lehman PB
- C) Prime Broker can provide financing via Repo or margin lending
- D) Prime Broker clears and settles trades between clients and brokers
- E) Prime Broker reports back to client (fund) the activity, position, interest, etc...

69. See Lehman Brothers, GCS-Prime Brokerage Client Services & Technology Reference Guide 2006 (May, 24, 2006) (unpublished internal manual) [LBI_PIR_000024]; Lehman Brothers, Global Client Services: Pitchbook (2006) [LBI_PIR_000198] (attached to e-mail dated Sept. 1, 2006 [LBI_PIR_000001] (including Prime Services Pitchbook)).

70. See Trustee's Second Interim Report for the Period May 30, 2009 through Nov. 11, 2009 ¶¶ 27-30, 37-41 (LBI Docket. No. 2055), available at www.lehmantrustee.com (the "Trustee's Second Interim Report").

92. LBHI held interests in certain of these entities, among them a 20% equity interest in D.E. Shaw, and interests in Spinnaker Capital Group, Ospraie Management LP, Marble Asset Management, and GLG Partners LP.⁷¹

93. LBI maintained distinct equity and fixed income prime brokerage divisions. In general, PBA holders entered into prime brokerage and related agreements with LBI, LBHI, LBIE, and their subsidiaries and affiliates. The typical arrangement for equity PBA holders was entry into several agreements: (i) a Customer Account Agreement (“CAA”) which established a prime brokerage account at LBI and included all Lehman entities as parties for certain purposes such as subjecting property in the account to claims and liens;⁷² (ii) Margin Lending Agreement (“MLA”) with LBIE;⁷³ and (iii) a Global Master Securities Lending Agreement (“GMSLA”), also with LBIE.⁷⁴ Under these arrangements, PBAs could borrow from LBIE and receive enhanced leveraging of short positions beyond what would be allowable under the requirements of Federal Reserve Board Regulation T, 12 C.F.R. § 220, in the United States. These contractual arrangements also granted the Lehman entities broad rights of re-

71. Yalman Onaran & Jenny Strasburg, *Lehman Brothers Buys Stake in Hedge Fund D.E. Shaw*, (Mar. 13, 2007), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aQdAgw1hmPRo&refer=home>.

72. The CAA “set[] forth the terms and conditions under which Lehman Brothers [defined to include LBI, LBIE, LBF, LBSF, LBHI, and their subsidiaries] will open and maintain prime brokerage account(s) in [the entity’s] name and otherwise transact business with [the entity as a] customer.”

73. The MLA between LBIE and the PBA holder “govern[ed] all loans of money or securities” that LBIE made to the PBA holder in connection with transactions pursuant to the CAA.

74. The GMSLA governed loans involving the exchange of securities or financial instruments for collateral, with either LBIE or the PBA in the position of lender.

hypothecation and continuing liens and first priority security interests in PBA holders' assets.⁷⁵

The fixed income PBA agreements did not provide for these broad rehypothecation rights.

94. For those PBAs that received margin financing from LBIE, LBI, acting as LBIE's agent, maintained internal facilitation accounts that allowed for trading of U.S. securities from a PBA holder's LBIE accounts. These accounts were maintained for bookkeeping convenience and did not alter the LBIE/LBI clearing relationship or the LBIE customer relationship. In the normal course of business, internal facilitation accounts would settle at the end of each business day, but LBIE's entry into administration disrupted this system and has caused some confusion about the account relationships among LBIE and its customers.⁷⁶ The confusion was compounded when Barclays erroneously issued a set of account statements September 30, 2008 with respect to the internal facilitation accounts even though they were not customer accounts and had not in fact been purchased by or transferred to Barclays.

95. As part of its prime brokerage business, LBIE maintained with LBI omnibus accounts that included securities for LBIE's clients on an aggregate rather than on a customer-by-customer basis. LBIE deposited collateral for margin lending with LBI, which was tracked in an omnibus account managed by the Prime Broker Cash Team in Jersey City, New Jersey to satisfy Regulation T and the OCC's margin requirements.

(c) Certain LBI subsidiaries

i. LCPI

96. LCPI was a wholly-owned subsidiary of LBI that originated as a commercial paper dealer but became principally engaged in the origination and trading of

75. Trustee's First Interim Report at ¶ 30, Ex. 7; Trustee's Second Interim Report at ¶¶ 37-41.

76. Trustee's Second Interim Report at ¶ 40.

secured and unsecured loans, as well as warehouse loans and other loans backed by mortgage loans and other assets. LCPI derived “investment banking income” from debt underwriting services for clients (including Lehman entities) seeking to raise money in the capital markets.

97. LCPI’s primary focus was mortgage and asset-backed securitizations. LCPI would purchase the assets, such as commercial and residential mortgages, home equity loans, and government and corporate bonds, from LBHI or other Lehman affiliates, and then, through special-purpose entities such as the RACERs described below, package the assets in securitization deals. These activities generated income for LCPI in the form of dividends and interest on the assets in its inventory, investment banking and underwriting fees, and investment trading profits.

98. LCPI was funded through repos, bank credit facilities, and loans from LBHI. Although much of LCPI’s funding came from LBHI, LBI’s balance sheet and potentially its capital for regulatory purposes were impacted by losses at LCPI. As LCPI required cash infusions to address capital deficiencies, those transfers were made in the form of transfers from LBHI to LBI, which, in turn, provided cash to effectuate the ultimate paydowns to LCPI.⁷⁷

ii. LBSF

99. LBI conducted its activities in fixed income derivative products through its wholly-owned special purpose subsidiary, LBSF, and LBSF’s separately capitalized subsidiary, LBFP.⁷⁸ At LBI, “preferred margin lending” was exclusively for fixed income securities and required a \$500,000 minimum for the preferred rate. LBSF was the firm’s

77. LBI actually paid the cash back to LBHI for the benefit of LCPI, which did not have bank accounts in its own name into which it could receive the funds directly.

78. See Lehman Brothers Holdings Inc., Annual Report (Form 10-K), at 47 (Feb. 28, 1996).

principal dealer in over-the-counter (“OTC”) derivative products, including interest rate, currency, credit, and mortgage derivatives. LBSF’s derivative transactions were guaranteed by LBHI. Lehman Brothers Commodity Services Inc. (“LBCS”) was established in 2005 as a wholly-owned subsidiary of LBSF. LBCS was engaged in commodities trading worldwide in the oil, natural gas, and power markets and traded in all major financial products including futures, swaps, options, and structured products. LBCS and its entities, including Eagle Energy Partners I, L.P., were regulated by the Federal Energy Regulatory Commission (“FERC”). Thus, LBSF and LBCS represented LBI’s fixed income division derivatives and energy business.

100. Once LBHI’s Chapter XI filing occurred, LBSF found itself in a dire liquidity crunch, to the point that it essentially did “not have any cash” to pay its counterparties.⁷⁹ Faced with the difficulty of generating cash and payments from an insolvent LBHI, LBSF turned to LBI, but LBI could not provide cash directly to LBSF without creating potential regulatory issues. Employees attempted intercompany transactions, such as repos, between LBSF and LBI, as an alternative, but as the week continued and LBI’s liquidity position worsened, even this alternative dissipated.

101. LCPI and LBSF had been LBI subsidiaries for many years. LBSF may have been maintained as an LBI subsidiary, rather than as an LBHI subsidiary, because it could do split hedge transactions with LBI. Similarly, LCPI, as a subsidiary of a regulated broker-dealer rather than a holding company, might have attracted more favorable credit terms, although LBI did not guarantee LCPI’s losses. Regulators insisted that LBI might have to report any reduction in the value of its investments in LBSF and LCPI for regulatory purposes, and the

79. E-mail dated Sept. 16, 2008 [LBI_PIR_000019].

status of these entities as subsidiaries therefore complicated its compliance and financial position when the markets imploded. In light of these issues, and the compounding difficulties LBI was then experiencing in the marketplace, some LBI personnel turned attention over the summer of 2008 to possible ways to “move LBSF and LCPI out of the LBI chain,” but were never able to do so given the turmoil of events. (This transfer out of the broker to the holding company was different from the “SpinCo” plan reported on by the Examiner; that plan contemplated a spin-off of illiquid assets to shareholders.⁸⁰) Eventually, on the eve of LBI’s filing, these and substantially all other LBI subsidiaries were transferred to Lehman ALI in exchange for the PIK note, which represents the value on a to-be-determined basis of the subsidiaries as of the time of the transfer.

iii. RACERS

102. RACERS, or “Restructured Asset seCurities with Enhanced ReturnS,” were special-purpose vehicles set up to facilitate structured transactions between LBI and other Lehman affiliates, among them LBI’s subsidiaries, LBSF and LCPI. The RACERS were set up as trusts pursuant to Trust Agreements between LBI, as purchaser of notes, and U.S. Bank Trust National Association, as owner trustee. The principal assets of the trusts were (i) securities in the form of a variable funding note secured by collateral that might be contributed by LCPI, and (ii) the rights under a 1992 International Swaps and Derivatives Association Inc. (“ISDA”) Master Agreement (the “Swap Agreement”) with LBSF, pursuant to which the trust would exchange all payments received in respect of the underlying securities for payments from LBSF. These payments were then used to pay all amounts due on the variable funding notes issued by the

80. See Examiner Report at 640-61.

trusts and secured by the underlying actions. As noted in the RACERS offering materials, LBHI guaranteed the payment obligations of LBSF under the Swap Agreements.

103. The market value of the collateral securing the variable funding note was required to be either (1) 105% of the outstanding principal amount of the variable funding note; or (2) if LBHI's credit rating fell below a certain level, 120% of the outstanding principal amount of the variable funding note.

104. To date, the Trustee has identified RACERS trusts from 2004, 2005, 2006, and 2007.⁸¹

105. The collateral for the RACERS consisted of "eligible assets," defined to include corporate and commercial loans and commercial real estate collateral. The assets in RACERS trusts were initially rated highly, receiving an A rating from Moody's, but as the trusts grew to \$5 billion, they no longer complied with the requirements to maintain that rating. In September 2008, LBI took steps to "upsized" the trusts again, but by that point LBHI's rating as the trusts' guarantor was a limiting factor.

106. While RACERS were eligible for PDCF trades with FRBNY, other banks would not accept them. Still others, such as JPMC, initially accepted RACERS as collateral, but became concerned with the product and eventually stopped using Lehman's pricing for RACERS.

81. For further details regarding the eventual configuration of one of the RACERS, see the Order Pursuant to Section 363 of the Bankruptcy Code Amending The RACERS Transaction Documents and Terminating Certain RACERS Transaction Documents, dated Aug. 19, 2010 (LBHI Docket No. 10943); Motion of Lehman Brothers Holdings Inc. and Lehman Commercial Paper Inc. Pursuant to Section 363 of the Bankruptcy Code to Amend The RACERS Transaction Documents and Terminate Certain RACERS Transaction Documents, dated July 27, 2010 (LBHI Docket No. 10464); and the Statement of the SIPA Trustee Regarding Motion of Lehman Brothers Holdings Inc. and Lehman Commercial Paper Inc. Pursuant to Section 363 of the Bankruptcy Code To Amend the RACERS Transaction Documents and Terminate Certain RACERS Transaction Documents (LBHI Docket No. 10742).

2. The role of clearing banks and LBHI in financing LBI and its subsidiaries

107. LBHI guaranteed many of the credit default swaps and derivatives entered into by LBI subsidiaries. Particularly in the last months of its existence, LBI also sought assistance from LBHI in funding its operating obligations, including obligations to LBI's clearing banks on whom LBI relied to carry accounts, clear transactions, and settle accounts with third parties.

108. LBI's daily operations were supported in part by JPMC, which acted as LBI's principal clearing bank. In this capacity, JPMC maintained operating, clearing, service, and other accounts to handle large securities, cash, and other transactions on behalf of LBI on a daily basis. Huge amounts of LBI's proprietary and LBHI's assets were pledged to JPMC to support this necessary activity— but also nevertheless included in LBHI's "liquidity pool."⁸²

109. Citi was LBI's designated settlement member on the CLS system, operated by a consortium of banks for the clearance and settlement of foreign exchange trades. In the process of settling trades for LBI on the CLS system, Citi extended intraday credit to LBI.⁸³

110. As noted, LBHI loaned substantial amounts of cash and securities to LBI on a subordinated basis. The cash actually originated from LBI profits; these would be transferred in the form of dividends to LBHI, which would in return contribute a portion back to its original source, LBI, in the form of a subordinated loan. Several LBHI subsidiaries were also parties to "non-conforming subordination agreements" with LBI, meaning that their claims were

82. See Examiner's Report at 1083, 1124, 1454-63.

83. Citi also provided LBI with other financial services, such as maintaining cash deposit and custodial accounts, providing credit facilities, and some custody and clearing services in emerging markets and in the United States.

subordinated in whole or in part to the prior payment or provision in full of any indebtedness due to any LBI creditor.⁸⁴ LBI acted as the Lehman designee for the “clearance box” at the Depository Trust Company (“DTC”, a DTCC subsidiary), which contained those securities that the clearing agency held for the broker-dealer.⁸⁵ Other Lehman entities maintained accounts at LBI to hold securities for various purposes related to their or their own customers’ transactions. As part of those relationships, those Lehman entities executed subordination agreements with LBI, which allowed LBI to use securities reflected in the accounts as collateral for financing.

111. Throughout 2008, LBI received funding from LBHI in the form of “master notes” to assist with losses at its subsidiaries. These master notes were distinct from LBI’s requests for capital infusions to subsidiaries and designed to improve LBI’s net capital position as the broker-dealer’s financial challenges mounted. In March 2008, in recognition of the difficult market environment at the time of Bear Stearns’ well-publicized crisis, LBI requested a “cushion” of \$1 billion to address intercompany balances and compensate LBI for unforeseen losses, and a master note of more than \$2 billion to remain open until further notice. By the end of August, LBI requested yet another loan from LBHI in the form of a master note of more than \$3 billion.

112. By the end of 2007, the subprime mortgage crisis had put LBHI into serious financial trouble. LBHI’s subsidiaries, such as its commercial real estate division, were

84. See Trustee’s First Interim Report at ¶ 48.

85. DTCC (“Depository Trust & Clearing Corporation”) provides clearance and settlement services for broker-to-broker transactions in equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments, and over-the-counter derivatives. LBI relied on DTCC’s services to complete the clearance and settlement of its transactions and also processed through accounts at DTCC’s subsidiaries. As of September 19, 2008, more than \$500 billion in open trading positions, largely for the benefit of customers and other LBI counterparties, were reflected in LBI’s accounts at DTCC. See Trustee’s First Interim Report at ¶ 79, n.9; The Depository Trust & Clearing Corp., Annual Report, 4, 13-7 (2008), available at www.dtcc.com/downloads/annuals/2008/2008_report.pdf.

laden with now-toxic assets, and the firm was undercapitalized.⁸⁶ In 2007, LBHI injected funds into LBI to be provided to LBI's struggling subsidiaries, especially LBSF and LCPI.⁸⁷ As noted above, in August 2008, some at Lehman recommended that these LBI subsidiaries be transferred out of LBI, but the regulatory and tax consequences were complicated as long as those entities remained capital deficient and events overtook formulation and implementation of any such plan.

113. The capital infusions process generally involved two actions: first, a transfer of funds from LBHI to LBI, and second, a simultaneous transfer of funds from LBI directly to a subsidiary. Some of LBI's subsidiaries, however, did not maintain their own bank accounts. Consequently, LBI would transfer the money back to LBHI, designated for the specific LBI subsidiary. Some of these transactions were recorded as straight infusions.

114. Generally, LBI used paydowns to provide capital infusions of cash to subsidiaries in which LBI had a negative investment. Paydowns occurred in 2008, as LBI sought to shore up its failing subsidiaries, such as LBSF, LCPI, and LB I Group.

115. For example, in March 2008, LCPI, LB I Group, and Ribco, an LBI special purpose corporation, required capital infusions totaling \$450 million. LBHI sent a paydown to LBI, which then sent the cash to the subsidiaries. LCPI required \$200 million, LB I Group required \$200 million, and Ribco required \$50 million. None of these subsidiaries maintained their own accounts, so LBHI ultimately received the funds on their behalf. Only two months later, on May 30, LCPI and LB I Group required additional infusions from LBI. In July 2008, Lehman's regulators required infusions to address capital deficiencies at Lehman

86. *See, e.g.,* Fishman, *supra* note 18, at 28.

87. For example, in August 2007, LBSF paid a \$500 million dividend to LBI, which would be transferred to LCPI as an infusion from LBI. Additionally, in May 2007, LCPI, LB I Group, and LBSF received a capital infusion from LBI; LCPI received \$150 million, LB I Group \$250 million, and LBSF \$100 million.

subsidiaries. After an evaluation by the regulators, LBI employees concluded that LCPI had a capital deficiency of about \$140 million and LB I Group of about \$50 million. Also in July 2008, “FINRA expressed grave concern over LBI’s funding of the negative equity with it’s [sic] own capital. These entities are not guaranteed subsidiaries and future deficits must be funded by Holdings.”⁸⁸ FINRA then threatened to require LBI to consolidate the assets and risks of these entities on its statement of net capital, potentially resulting in a deduction of capital (rather than having them excluded from the calculation). LBI informed FINRA of a \$1 billion capital infusion for LCPI and LB I Group on August 28.

116. Just before LBHI’s Chapter XI filing, the motivation for paydown requests changed from seeking to address capital deficiencies to focusing on intercompany balances and avoiding regulatory charges. For example, on September 12, 2008, a request was made for a paydown from LBI to LBIE for \$268 million to address intercompany balances. While many of these transfers appeared to be fairly routine, others resulted from errors or miscommunication, which added to the turmoil of the intercompany financing regime at a time when LBI struggled to operate in the wake of LBHI’s Chapter XI filing.

117. The manner in which paydowns occurred just prior to the commencement of LBHI and LBIE’s insolvency proceedings further complicated the records relating to LBI’s financial position, and thereby, the Trustee’s ability to facilitate LBI’s liquidation. While intercompany transfers, in the ordinary course, would net to an intercompany balance on a daily, weekly, or even monthly basis, this process was interrupted with the commencement of LBHI’s and LBIE’s insolvency proceedings, leaving in place interim balances that would otherwise have

88. See E-mail dated July 29, 2008 [LBI_PIR_000003].

settled still not reconciled on both sides of the relationship. The process of unwinding and attempting to reconcile these balances has been very labor intensive, as described in earlier reports.⁸⁹

3. Some relevant aspects of the LBI-LBIE relationship

118. For purposes of this Preliminary Report, the Trustee sets forth some of the elements of LBI's relationship with LBIE that significantly impacted the ways in which LBI operated, and subsequently created difficulties when LBIE went into administration.

(a) Daily operations of the LBI-LBIE relationship

119. LBIE was Lehman's principal European broker-dealer; consequently, LBI used LBIE as its clearing and settlement agent for certain LBI trades outside of the U.S., just as LBIE used LBI to clear trades within the U.S. As part of this arrangement, LBI and LBIE settled trades, in both directions, on a daily basis until LBIE filed its own administration proceeding on September 15. Among the transactions between the two entities, LBI engaged in a substantial number of repos with LBIE. The extent of this relationship understandably created substantial default risks by tying LBI and LBIE together through numerous transactions. As LBHI's financial situation worsened, executives considered whether a default event caused by problems at LBIE would also amount to a default event on the part of LBI, or vice-versa. These executives determined that "typically [a] default or insolvency event by LBHI, LBIE or LBSF would NOT be a default on LBI[']s Repo Business."⁹⁰

89. See Trustee's Third Interim Report at ¶¶ 19-30.

90. Lehman Brothers, Back-Up Contingency Plan (Sept. 12, 2008) [LBI_PIR_000118] (Likewise, "...a default or insolvency event by LBHI, LBI or LBSF would NOT be default on the LBIE Repo business (although this could be negotiated on case by case basis)") (attached to e-mail dated Sept. 12, 2008 [LBI_PIR_000009]).

120. LBI and LBIE also made intercompany paydowns in cash to each other. These payments helped to minimize regulatory charges resulting from intercompany balances. As LBIE approached administration, paydowns from LBIE to LBI were no longer available to settle intercompany balances and avoid regulatory issues. During this period, trapped liquidity balances increased. Trapped liquidity occurred when regulatory, rating agency or operational restrictions precluded LBI from using assets such as margin posted to it by non-regulated Lehman entities, which could otherwise be used to support activity outside of LBI.

(b) LBIE Acting as Settlement Hub for Transactions in Europe and Certain Jurisdictions

121. Prior to administration, LBIE undertook settlement activities for certain LBI trades transacted in clearing systems and depots in Europe and certain other jurisdictions (as LBIE did for similar trades for other Lehman entities). LBIE undertook these settlement activities pursuant to a policy within the wider group of Lehman entities which called for securities trades with the Street for the account of any Lehman entity to be settled by the Lehman entity in the same jurisdiction as the relevant depots through which such securities were traded or in which such securities were held. The Trustee understands that this was known as the “local settlement policy.” LBIE claims to have assumed this role to minimize costs and logistical difficulties that arise when different affiliates hold clearing house or depository accounts for trading of securities.

122. The Joint Administrators of LBIE have commenced court proceedings in the English High Court to determine the legal effect of an internal process known as RASCALS (Regulation and Administration of Safe Custody and Global Settlement System) on title to securities purchased by LBIE as local settlement agent for affiliates (including LBI) and held by LBIE in its house depots. LBIE contends that it is the beneficial owner of such securities from

point of purchase. Various affiliates, including LBI, have entered appearances in that proceeding. The Trustee disputes LBIE's assertions and is currently investigating the factual background to the issues raised by LBIE's application.

123. According to evidence and statements of case filed by LBIE in its application:

(i) Under the local settlement policy, LBIE settled securities trades for the affiliate, and entries were made in the books of LBIE and the affiliate to reflect the new inventory positions of the affiliate.⁹¹ These transactions resulted in an unsecured debt owed to LBIE by its affiliates relating to the acquisition cost of securities because the economic benefits (or risks) for those trades were attributed to the participating affiliate;⁹²

(ii) In the mid-1990's, LBIE developed the RASCALS process, intended to resolve legal, compliance and regulatory capital issues that arose on inter-company accounts resulting from one company settling another's trades.⁹³ The impetus for creating the RASCALS process was then-pending changes to the U.K. European Capital Adequacy Directive. Under such pending changes, the unsecured debt arising as a result of LBIE's purchase of securities for affiliates

91. First Witness Statement of Thomas Bolland, submitted in the Matter of Lehman Brothers International Europe (in administration) [Nov. 27, 2009] EWHC (Ch), No. 7942 of 2008, ¶ 16.

92. *Id.*

93. *Id.* at ¶ 42.

would have exposed LBIE to regulatory capital charges.⁹⁴ These revised capital requirements came into effect in 1996⁹⁵; and

(iii) The RASCALS process involved two financing tools: (a) entries in the Lehman Group's internal computer systems purportedly recording overnight report (under which affiliates "sold" securities to LBIE and LBIE agreed to transfer equivalent securities back to the affiliate the next day, a process which ran on a daily basis that was eventually automated) or (b) stock loans — under which affiliates "loaned" securities to a borrower in return for a transfer of collateral, usually cash. At the end of the term of the loan, securities were returned to the lender, the equivalent collateral was returned to the borrower, and the borrower paid a fee to the lender based on the value of the securities. These overnight financing transactions provided several advantages over the old method for LBIE — they incurred little to no regulatory charges in the U.K. and generated cash balances on the books that could be settled daily.

124. LBI did not sign any agreement related to the RASCALS process.⁹⁶ As a broker dealer in the U.S., LBI could not make unsecured loans to affiliates except in very limited, stringent circumstances. Rather, LBI's relationship with LBIE was primarily governed by the 1996 Undisclosed Custody and Brokerage Services Clearing Agreement ("UCCBSCA"). LBIE claims that the UCCBSCA gave effect to the RASCALS process as between LBIE and

94. *Id.* at ¶ 16.

95. *Id.* at ¶ 33 (citing Brian Nicholson, RASCALS Project, A Solution to Regulatory and Compliance Issues For Cross Company Settlement on ITS (Mar. 1995)).

96. *Id.* at ¶ 66.

LBI. The Trustee disputes this based on the clear terms of the UCCBSCA. The Trustee's position is that the RASCALS process did not affect securities purchased by LBIE on LBI's behalf and that LBI — not LBIE — has the prior entitlement to and ownership of such securities.⁹⁷

**V. SOME CONSEQUENCES OF LBHI'S INSOLVENCY FILING
AND THE IMMINENCE OF THE SIPA LIQUIDATION**

125. Ultimately, LBHI's financial instability led to the largest insolvency filing ever when LBHI sought Chapter XI protection on September 15, 2008. Almost simultaneously, LBIE was placed into administration in the U.K. Four days later, this SIPA liquidation proceeding commenced.

126. In the days leading up to September 19, LBI employees and governmental agencies, in particular the FRBNY, the SEC, the CFTC and FINRA, worked diligently to wind down LBI while simultaneously encouraging a sale of the broker-dealer business to another viable entity in order to enable the orderly transfer of customer accounts and minimize disruption of the markets.

127. The reality of the liquidity crisis, however, prevented an orderly wind-down. In this section, the Trustee outlines some of the significant events that occurred in the immediate aftermath of the LBHI, LBIE and LBI filings.

A. Immediate Impacts Of Insolvency Filings

128. By the time of the SIPA filing, if not before, JPMC unilaterally shut off access to information systems that LBI personnel and later the Trustee used to monitor account activity. In doing so, the bank prevented LBI from identifying incoming customer property and

97. Position Paper of Lehman Brothers Inc., in the matter of Lehman Brothers International (Europe) (in administration) [May 10, 2010] EWHC (Ch), No 7942 of 2008.

providing segregation instructions to JPMC to ensure that customer property was properly segregated and protected. In addition, JPMC did not return calls from LBI personnel, making any attempts to provide segregation instructions manually unsuccessful. As a result, customer property that could not be identified and manually segregated was deposited in unsegregated accounts and treated by JPMC as collateral for LBI's obligations.

129. As the liquidation began, the Trustee understood that LBI still had a large number of customer as well as proprietary assets in its accounts at JPMC, but had insufficient information or access to the accounts to provide delivery instructions to use the funds to meet customer account transfer requests. In addition, the Trustee understood the need to ensure that the cash proceeds of customer futures positions, which foreign clearing banks had liquidated, were treated as customer property by JPMC and placed into the segregated funds account at JPMC in the U.S.

130. In order to gain visibility and access to the accounts and information necessary to determine LBI's financial position and execute deliveries for the benefit of customer accounts, the Trustee, SIPC, LBHI and Barclays entered a "Services and Settlement Agreement" (the "SSA") on September 22, 2008 with JPMC setting forth terms and conditions under which JPMC would provide continued clearing, settlement and other processing services to LBI post-petition.⁹⁸ The SSA provides that JPMC shall continue to provide clearing, settlement and other processing services in the Accounts (a) to facilitate an orderly liquidation of securities positions remaining in the estate of LBI by the Trustee, and (b) process LBI

98. Services and Settlement Agreement between JPMorgan Chase Bank, N.A., Barclays Capital, Inc., and James W. Giddens (LBI Trustee) dated Sept. 22, 2008 at ¶¶ 1, 3 [LBI_PIR_000300].

transactions for which JPMC had received bona fide instructions on or before 6 p.m. ET on September 19, 2008.

131. In the immediate aftermath of LBI's filing, and in connection with Barclays' refusal to assume certain accounts, the Trustee initiated the prime brokerage account transfers. Fixed income division ("FID") PBAs were maintained primarily through LBI's clearing relationship with JPMC. For two weeks the Trustee's professionals (and Barclays employees assisting the Trustee) reconciled the assets transferrable to these fixed income PBAs using the final set of records that JPMC had provided shortly before the filing date. This information, however, had quickly become stale and inaccurate, as the securities in these accounts matured to cash (with corresponding principal reductions) or paid interest. To create reconciliations for the accounts prior to transfer, the Trustee's professionals could not rely on information that would have normally been provided by JPMC. Not only did this create an extra research layer, it impeded "real world" reconciliation because actual payment date was not being provided and the Trustee's professionals were estimating payments based on how these positions should have behaved.

132. Only after execution of the SSA and various Confidentiality Agreements pursuant to the SSA did JPMC agree to provide the Trustee with some visibility and access to LBI's accounts which permitted the Trustee to make deliveries for the benefit of customers. However, due to the lack of screen access on September 19, 2008 and thereafter, there were a significant number of breaks and discrepancies between LBI's records and the positions in its accounts at JPMC when the Trustee's professionals regained access. As a result, the Trustee's professionals first had to reconstruct the securities movements during the days when JPMC was custodian of the accounts without any visibility or access to LBI. The Trustee's professionals

then had to reconcile JPMC's records, LBI's account positions, and LBI's records to close of business on September 19, 2008 and to the time the petition was filed commencing the LBI SIPA Proceeding at 1:29 p.m. on September 19, 2008.

133. The lack of full and immediate screen access to the Trustee's professionals also delayed the Trustee from knowing that JPMC had seized assets related to the fixed income PBAs for nearly a month. The Trustee did not learn until on or around Wednesday, October 15, 2008, while in the course of attempting to transfer prime brokerage accounts, that the bank had seized cash and securities in the FID accounts, despite the existence of "no lien letters" that were intended to bar such seizure. Operating on the basis that JPMC would honor segregation requirements, the Trustee had indicated that securities and cash related to these accounts would be transferred to fixed income account holders as soon as procedures were in place and approved and appropriate releases were received. Discovery of the JPMC-seized FID assets was concurrent with attempted deliveries of cash and securities to account holders when records for the filing date and September 22 were finally provided. Obviously, these transfers could not be made. It took a further six weeks for the Trustee to obtain account information from JPMC and negotiate the cash substitution agreement described below to allow the securities to be transferred to these account holders.

134. Upon learning of the seizures, the Trustee immediately demanded the return of the cash and securities contained in the FID accounts. JPMC refused. Based on the imperative to return customer securities, the Trustee negotiated and entered into a Substitution Agreement with JPMC on or around December 5, 2008 (the "Substitution Agreement"). Under the Substitution Agreement, the Trustee delivered \$582,215,585.00 in cash to JPMC to secure the immediate recovery of the customer securities seized by JPMC. In order to accomplish the

delivery of customer securities, the Trustee was required to substitute funds which otherwise could have been used in the interim period to satisfy other customer claims. The Trustee has investigated, is discussing with JPMC, and is prepared to litigate if necessary, the propriety of JPMC's seizure of the securities which had been subject to a "no-lien" letter.

1. CME's reaction to LBHI's insolvency and LBI's impending liquidation

135. The implications of LBHI's bankruptcy filing on the "orderly wind-down" of the broker-dealer are evident in the eventual auction of LBI's house portfolio at the CME.⁹⁹

136. The CME's rules provide the CME with broad discretion to act as it sees fit when one of its clearing members is in financial straits and jeopardizes "the integrity of the Exchange, or negatively impacts the financial markets by introducing an unacceptable level of uncertainty, volatility or risk, whether or not the clearing member continues to meet the required minimum financial requirements."¹⁰⁰ The CME's rules permit the CME under such circumstances to order, among other things, the liquidation of a clearing member's positions.

Specifically, CME Rule 975 provides:

If the President of the Exchange or the President of the Clearing House determines that the financial or operational condition of a clearing member or one of its affiliates is such that to allow that clearing member to continue its operation would jeopardize the integrity of the Exchange, or negatively impacts the financial markets by introducing an unacceptable level of uncertainty, volatility or risk, whether or not the clearing member continues to meet the required minimum financial requirements, he may empanel the Chief Executive Officer, the President of the Exchange, Chairman of the Board, the Chairman of the Clearing House Risk Committee and the President of the Clearing House ("Emergency

99. CME Group Inc. is composed of four Designated Contract Markets: the CME, the Chicago Board of Trade (CBOT), the New York Mercantile Exchange (NYMEX), and Commodity Exchange, Inc. (COMEX). As of August 2008, the NYMEX was a separate entity from the CME. The two merged into the CME Group on September 30, 2008.

100. CME Rule 975; Emergency Financial Conditions, CME Rulebook, 24-25 (Dec. 2008), *available at* <http://www.cmegroup.com/rulebook/CME/I/9/75.html>.

Financial Committee”). Such panel shall be duly authorized and, upon a unanimous vote of the panel, be empowered to order (a) an immediate position limitation, (b) an immediate suspension of the clearing member, (c) that all open trades of said clearing member be for liquidation only, (d) the liquidation or transfer of all or a portion of the open positions of the clearing member, (e) additional performance bond to be deposited with the Clearing House and/or (f) any other action necessary to protect the financial integrity of the Clearing House. The clearing member affected by action taken shall be notified and may request a hearing before the Board as provided in Rule 412. In the event of suspension, the Chief Executive Officer shall, promptly after a suspension, set the matter for hearing before the Board for final determination. To the extent that the panel orders that all open trades of a clearing member be for liquidation only, or the panel orders the liquidation or transfer of all of the open positions of a clearing member, Rule 913.B. shall apply and the clearing member shall be treated as a withdrawing clearing member.¹⁰¹

137. Pursuant to a meeting of the CME’s Emergency Financial Committee on the night of Sunday, September 14, the CME directed LBI on the afternoon of September 15 to limit trading in its house accounts for liquidation only. The CME took this action notwithstanding the fact that LBI had satisfied all financial requirements of a CME clearing member. In fact, LBI continued to meet its financial requirements at the CME throughout the remainder of that week.

138. Although LBI received the CME’s liquidation-only message on the afternoon of Monday, September 15, the lines of internal communication and the personnel necessary to execute a liquidation were hampered as a result of the LBHI filing earlier that morning. The participation of approximately 100 traders covering 30-40 different trading ledgers in time zones around the world would have been necessary to effect a liquidation on that scale, but many traders simply did not show up to work, or showed up without any incentive to do the work required once news of LBHI’s filing circulated. Even if the necessary traders had

101.NYMEX Rule 9.06A is identical to CME Rule 975. See NYMEX Rule 9.06A.

been available, they would have encountered little direction from management, which was distracted by the impending transaction with Barclays and other emergencies stemming from LBHI's filing. Although the sale of a portion of Lehman's energy portfolio was orchestrated within the next few days, it was not until early on the morning of September 17 that certain of LBI's traders were advised that LBI would "start working on unwinding our futures book" that day.¹⁰²

139. The LBHI filing impacted not only the supervision and execution of a liquidation of the broker-dealer, but also dramatically impacted LBI's potential exposure in the commodities markets and LBI's ability to liquidate those positions to its benefit. LBI's portfolio at the CME was, in large measure, a mechanism to hedge non-exchange-traded swaps contracts for the energy businesses conducted by LBSF and LBCS. LBHI was a guarantor of the swap contracts of its subsidiaries and affiliates. As a result, under the ISDA agreements and schedules governing the swaps, the bankruptcy filing of the guarantor — LBHI — constituted an event of default, thereby freezing those trades. Among the effects of such a freeze was that the positions in LBI's house portfolio — which had been placed as hedges to offset the risk of the swaps — now stood on their own, exposed to market turbulence at a time of unprecedented market volatility. While theoretically LBI could liquidate the naked hedges, the inability to offer both sides of the hedge would render any potential liquidation at favorable prices an impossibility: any counterparty would require substantial additional collateral to assume the significant exposures as well as the margin requirements imposed by the exchanges for maintaining such large exposures.

102.E-mail dated Sept. 16, 2008 [LBI_PIR_000020].

140. The first major piece of LBI's house portfolio to be auctioned was its NYMEX natural gas futures and options positions. This auction was conducted by LBI, which sought bids from three market participants identified by the CME: Goldman Sachs, JPMC, and Morgan Stanley. Goldman Sachs ultimately provided the only, and thus the winning, bid. The parties agreed upon the following terms: the transfer of the positions to Goldman at the Tuesday September 16 closing prices, along with over \$622 million of collateral.¹⁰³ The collateral was in the form of money market funds that LBI pledged to the CME, which the CME liquidated, with LBI's consent, to provide the cash to Goldman. Due to operational delays in transferring the bulk positions to Goldman, the deal terms changed as the positions did not transfer until Thursday, September 18, at Wednesday's closing prices. As a result of market movements against LBI's futures positions on September 17, LBI's account at the CME was debited \$82,654,310, which amount was deducted from the amount of collateral to be transferred to Goldman.

141. LBI's ensuing efforts to liquidate the remainder of its futures and options positions were minimal, despite repeated urgings from the CME on Tuesday September 16 and Wednesday September 17. At some point late Wednesday, the CME learned that Barclays would purchase LBI's customer, but not house, positions. The CME then agreed to conduct its own auction of LBI's remaining house positions. Very early on the morning of September 18th, the CME sent requests for bids, due by 8:00 a.m., to Goldman, Citadel, DRW, JPMC, and Barclays. LBI had no input into or participation in the CME's auction. Rather, the CME rejected LBI's pleas to halt or delay the auction until LBI had an opportunity to liquidate the

103. The collateral breakdown was as follows: \$482,104,458.98, equal to the portfolio net short option value; and \$140 million consisting of the Span risk margin for the portfolio (calculated to be approximately \$129 million) and "other consideration."

positions on its own, and went so far as to block LBI's ability to trade house positions on the market upon learning that LBI traders were attempting to execute trades Thursday morning.

142. In the aggregate, along with LBI's proprietary positions, the CME transferred to the winning bidders more than \$465 million in equity to offset the net short option value of the positions, as well as more than \$1 billion in risk-related "concessions," representing nearly all of the performance bond ("margin") that LBI had posted with the CME's exchanges associated with those positions.¹⁰⁴ The CME did not advise LBI of the specific bids, and only advised LBI of the amount of collateral transferred with the positions on Thursday afternoon. LBI internal emails reflect surprise by LBI personnel that its money market funds held at the CME would not be returned to LBI. At the September 19-20, 2008 Bankruptcy Court hearing regarding the sale of LBI's business to Barclays (the "Sale Hearing"), it was disclosed that the CME had wiped out the last available cash at LBI.

2. OCC's reaction to LBHI's insolvency and LBI's impending liquidation

143. Just as the CME invoked emergency powers to threaten to liquidate and auction LBI's positions, producing a loss to LBI, so too did DTCC and OCC threaten emergency actions that could have had disastrous effects for the account transfer process and, in DTCC's case, might have derailed the entire transaction with Barclays. The question of how clearing organizations and exchanges will react and what will happen to assets there is one that should be

104. LBI's CME/CBOT Equities portfolio was purchased by Goldman Sachs for a concession of \$450 million negatively offset by \$4,867,513 of net long option value. The original wire transfer to Goldman on September 18 failed to account for the long option value, but Goldman refunded the \$4,867,513 to LBI's CME account on September 19. LBI's CME/CBOT Rates portfolio was purchased by DRW Trading Corp. for a concession of \$240 million plus \$93,489,665 net short option value. LBI's CME FX portfolio was purchased by DRW Trading Corp. for a concession of \$6 million negatively offset by \$3,710,625 of net long option value. LBI's CME/CBOT Ags portfolio was purchased by DRW Trading Corp. for a concession of \$57 million negatively offset by \$4,547,638 of net long option value. LBI's NYMEX Energy/Other portfolio was purchased by Barclays for a concession of \$335 million plus \$372,413,215 net short option value.

studied and planned for in any future liquidation, as is discussed in the Recommendations section of this Report. A complicating factor in LBI's case was the fact that September 19 was a triple-witching day, greatly increasing the volume of transactions to be dealt with and posing concerns about market-wide effects.¹⁰⁵

144. The OCC threatened to liquidate all the LBI positions unless Barclays stepped into LBI's shoes at the OCC. The Trustee agreed to the transfer of LBI's accounts at the OCC to Barclays to preserve the customers' accounts at the OCC. Had Barclays and the Trustee not agreed to the transfer of accounts, customers would have found their accounts closed out in many cases at substantial losses with no ability to take any action to protect themselves or retain control of their positions.

145. By Friday morning, September 19, 2008, the OCC had begun taking steps to ensure that it would be protected against the possibility of losses stemming from LBI's liabilities to the OCC. Shortly before noon, the OCC's attorneys proposed inserting language into the Court's Order Authorizing the Sale of Purchased Assets and other Relief in the Lehman Brothers Holding Inc. Chapter XI Proceedings such that to the extent any LBI property at the OCC was included in the sale as a "Purchased Asset," Barclays would assume "all obligations to The Options Clearing Corporation ('OCC') with respect to Purchased Assets that are within the possession or control of OCC." Approximately two hours later, Barclays' attorneys confirmed that this language was not objectionable to Barclays, and it was included in the Sale Order.

146. A separate transfer and assumption agreement was presented to the Trustee during a brief recess in the sale hearing but was never approved by this Court. A dispute

105. On a "triple-witching day," which occurs four times each year on the third Friday of March, June, September and December, the contracts for stock index futures, stock index options and stock options all expire on the same day.

now exists between the Trustee and Barclays over the appropriate disposition of what the Trustee subsequently discovered to be substantial cash margin with respect to both customer and proprietary positions maintained at the OCC, much of which proved to be excess, *i.e.*, not necessary to cover liabilities. Moreover, having Barclays assume all customer positions and assets at the OCC proved to be an imperfect solution at best because many customers did not transfer to Barclays and had problems obtaining access to their OCC positions and margin. Clearly, issues such as these — compounded in LBI's case by the fact that September 19 was a triple-witching day — need to be considered on an industry-wide basis in advance, not in last-minute courtroom asides or email exchanges among only some of the parties involved.

3. DTCC's reaction to LBHI's insolvency and LBI's impending liquidation

147. DTCC, through its subsidiaries, provides clearance and settlement services for broker-to-broker transactions in equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and OTC derivatives. LBI relied extensively on DTCC's services to carry out clearance and settlement activity in the ordinary course of its business, maintaining accounts at DTCC subsidiaries, including NSCC, the Fixed Income Clearing Corporation ("FICC") and the DTC.

148. DTCC presented an even more serious issue than the CME or the OCC because of the vast amount of property it holds or custodies and the industry's reliance on it and its subsidiaries to settle trades and transfer customer property. For example, as of the closing of the sale transaction, DTCC estimates that it held over \$500 billion in open trades on Lehman's books. DTCC was so concerned with the potential cost that it indicated an unwillingness to perform settlement and transfer functions for LBI unless Barclays assumed all potential liability. When Barclays refused, DTCC insisted on substantial property being available to it to cover any potential losses it might face. Eventually, it was agreed that all LBI proprietary assets at DTCC

would remain with the Trustee and be available for DTCC's use — actually a much-needed benefit for the LBI liquidation but the subject of yet another dispute between the Trustee and Barclays — and that Barclays would additionally deposit the purchase price due to the estate with DTCC. Accordingly, the only cash to be paid by Barclays for the extensive brokerage business and over \$40 billion of customer accounts — \$250 million for LBI's "goodwill" — became a deposit with DTCC for Barclays' limited guarantee against losses. Thus, when the Trustee commenced liquidating one of the largest, most venerable brokerage houses in the world, he had to obtain an advance of one million dollars from SIPC, because otherwise there did not appear to be a dime of readily available proprietary cash.¹⁰⁶

149. DTCC had previously contemplated a total transfer of the LBI 074 box at DTCC to Barclays along with Barclays' assumption of liabilities; when this approach was abandoned, DTCC began to unwind LBI's positions as a broker-dealer whose membership was terminated. Unfortunately, DTCC deemed this to mean that the already commenced ACATS transfer process should be reversed, as described in the next section.

4. The DTCC-ACATS reversals

150. Among its services, NSCC operates the Continuous Net Settlement system ("CNS"), which automatically centralizes the settlement of broker-to-broker security transactions and maintains an orderly flow of security and money balances. Most broker-to-broker equity and corporate debt transactions settle through the CNS system.

106. The Trustee did have available cash in the Rule 15c3-3 account to help with account transfers and did within a few weeks manage to locate some funds in a few bank accounts. The Trustee also received some cash in transaction unwinds to which SIPC and the Trustee consented as an exception to the automatic stay, as provided for in the Liquidation Order. *See infra* Section IX.I.

151. NSCC also provides an ACATS service, which automates and standardizes procedures for the transfer of assets in a customer account from one brokerage firm or bank (the “Delivering Broker”) to another brokerage firm or bank (the “Receiving Broker”).

152. Assets in an ACATS transfer that are eligible for CNS processing are transferred from the Delivering Broker to the Receiving Broker through the CNS system. Assets ineligible for CNS are delivered by the Delivering Broker to the Receiving Broker by other methods.

153. Prior to the LBI SIPA Proceeding, many LBI customers had initiated (through Receiving Brokers) account transfer requests. These requests were submitted to LBI through the ACATS process and LBI proceeded to facilitate transfers of the requested accounts. Account transfers were scheduled to settle through ACATS between September 22, 2008 and September 24, 2008. At the opening of business on Monday, September 22, 2008, Receiving Brokers to which LBI customers desired to move their accounts were awaiting transfer through the ACATS system of certain customers’ securities (the “ACATS Securities”) that were scheduled to settle on September 22, 2008. Under the ACATS service, on the scheduled settlement date, the Delivering Broker (here, LBI) is debited for the value of assets to be transferred to the Receiving Broker.¹⁰⁷ Upon delivery of the assets, the Delivering Broker is credited back with the value of the transferred assets. While LBI had securities available to complete many of the September 22, 2008 ACATS delivery obligations, as described below, most of the ACATS Securities did not reach the intended Receiving Brokers.

107. The debit/credit only takes place if the account transfer is between two broker-dealers.

154. NSCC's processing of September 22, 2008 LBI transactions (which had begun on the evening of September 19, 2008) went forward on the morning of September 22, 2008. However, NSCC subsequently began to wind down the LBI account — effectively as if NSCC had as of September 22, 2008 ceased to act for LBI — pursuant to an agreement dated September 22, 2008, between and among DTCC, the Trustee and Barclays regarding the wind-down of the LBI account. NSCC reversed certain ACATS transfers for LBI customer accounts that had taken place on September 19, 2008 and all ACATS transfers for September 22, 2008 (the “ACATS Reversal”).

155. The result of the ACATS Reversal and other wind-down activity on September 22, 2008 through September 24, 2008 included: (i) NSCC taking possession of securities valued at approximately \$468 million, including a large amount of customer securities that should have been immune from seizure; (ii) securities valued at approximately \$374 million were received as long positions in the LBI DTC account; and (iii) securities valued at approximately \$221 million as of September 22, 2008 (again including customer securities) were sold or transferred in connection with the wind-down of LBI's account to settle other LBI obligations. The ACATS Reversal became the subject of a motion by the Trustee, and resulted in the Court's order of February 11, 2009 restoring conditions as nearly as possible to those that would have been obtained had the ACATS Transfers not been reversed.¹⁰⁸

156. All of the threatened actions by these three entities — the CME, the OCC and DTCC — took place in a rushed, confused, uncertain and near-panic atmosphere, which was exacerbated by uncertainty about the financial system beyond just Lehman and the fact that the

108. *See* Motion Under Fed. R. Bankr. P. 9019(a) for Approval of Settlement and Compromise, Settlement Agreement (among the Trustee, DTCC and Barclays) (LBI Docket No. 586).

date of LBI's liquidation was also a triple-witching day when contracts come due for settlement. All appear to the Trustee to have produced unforeseen, unfortunate consequences. The rules and procedures that might have applied in those circumstances were unclear, to a large degree unknown, and certainly untested. As we note in the Recommendations section, steps should be taken so that this should not be the case next time.

B. The Impact Of The Insolvency Filings On The LBI-LBIE Relationship

157. As LBIE was forced to enter administration in the U.K., the settlement of certain trades at LBIE resulted in the draining of cash from LBI.

158. Following LBHI's filing, payments could only be made to and from certain Lehman entities — specifically Neuberger Berman, LBI, LBB, LBCB, LOTC and LBCC FX — and all other payments to Lehman entities were blocked. That is, LBI assets that had been traded in overseas markets through LBIE were tied up in the LBIE administration process and only available to LBI with the LBIE administrators' approval. At the same time, LBIE made a demand for payment from LBI for more than \$8 billion related to transactions that supposedly closed before LBIE entered administration.

159. LBIE's administration presented LBI with a variety of default concerns. For example, where LBI financed a client's securities through a repo trade, LBI often did a back to back trade with LBIE. At the time of repurchase, LBI was now unable to unwind the LBIE trade and, as a result, failed on its obligation to deliver the securities back to the client.

160. By September 17, 2008, LBI executives worried about when LBIE's administrators would allow LBI's positions to transfer out, while LBI acted to address payments on margin accounts of customers whose positions were held at European exchanges.

161. During this period, LBI personnel were also unsure whether, and how, payable and receivable balances between two companies could be resolved. The relationship

with LBIE caused additional difficulties in unwinding open trades. In the Investment Banking Division alone, at least 15 million shares were “stuck.” This meant that in order to unwind a trade with a customer where LBIE would not deliver the securities, LBI would have to buy-in the securities, increasing its exposure and leaving it with only a claim back against LBIE.

C. Prime Brokerage Accounts, Reconciliation Status And The Trustee’s Protocol

162. PBAs are more complicated to administer in liquidation because of the nature of the accounts and trading, the terms of the agreements, and indebtedness to and liens in favor of LBI affiliates. Dealings with LBIE in this situation have added to the complexity. As noted earlier in this Report, many PBAs sought or were in the process of transferring accounts away from LBI as the insolvency filing of LBHI was rumored and then became an actuality.¹⁰⁹ It had originally been expected that Barclays would acquire the prime brokerage customers’ accounts as part of the sale transaction as contemplated in the agreements, but, on September 29, 2008, Barclays informed the Trustee of its refusal to acquire them, further complicating the liquidation.¹¹⁰

163. SIPC and the Trustee developed an innovative protocol (the “Prime Brokerage Protocol”)¹¹¹ under the customer account transfer provisions of SIPA that allowed the majority of LBI prime brokerage account holders to transfer substantial assets to other financial institutions (approximately 75% of LBI’s remaining prime brokerage business) and thereby

109. See *supra* Section IV.A.3.

110. Letter dated Sept. 29, 2008 [LBI_PIR_000022].

111. See Protocol of the Lehman Brothers Inc. Trustee Regarding Prime Brokerage Arrangements (Oct. 14, 2008), Trustee’s First Interim Report at Ex. 5 (the “Prime Brokerage Protocol”).

regain access to those assets. No other industry regime yielded such a prompt return of substantial amounts of customer property.

164. Despite the success of the Prime Brokerage Protocol, which was approved by the court in December 2009, not all of the PBAs property could be transferred. As a result, 1,206 PBA-related claims have been filed with respect to account-related transactions and other issues not covered by the Protocol.¹¹² Despite the flexibility afforded by SIPA, it would have been far more expedient, and would have resulted in more complete protection for the prime brokerage account customers, had Barclays or some other entity taken this important range of accounts as contemplated in the sale agreements.

D. Lehman's Communications With Customers About SIPA

165. LBI prepared communications for customers about SIPA and its role in the event of LBI's collapse which seem, in retrospect, somewhat naïve and superficial. These communications also evidence recognition of the possibility of a liquidation more than six months before the Filing Date, despite the apparent soundness of LBI in a narrow regulatory sense. (And, by inference, they show that it would have been possible to begin planning in earnest for an actual liquidation scenario months before the situation became desperate.)

166. On March 18, 2008, in the immediate aftermath of Bear Stearns' demise, the Managing Director and Global Head of Lehman's PIM business drafted a letter to reassure LBI clients about the financial health of Lehman and the financial markets in general.¹¹³ The letter also devoted a paragraph to Lehman's safeguarding of client assets. He wrote:

112. See Trustee's Third Interim Report at 19-30.

113. Letter dated Mar. 18, 2008 [LBI_PIR_000197] (attached to e-mail dated Sept. 12, 2008 [LBI_PIR_000007]).

With respect to the safeguarding and custodying of your assets, Federal law imposes structural safeguards and requires that your assets be segregated from Lehman Brothers' own property. As a result, they are not subject to the claims of the Firm's creditors. In addition to these protections, the Firm is also a member of the Securities Investor Protection Corporation ("SIPC"), which provides coverage in the case of a shortfall of the covered assets. The Firm also carries excess SIPC coverage through the Customer Asset Protection Company ("CAPCO").¹¹⁴

167. In addition to this letter, LBI created materials to address client concerns about the safety of their assets held at LBI, including the following: (i) a document containing a list of bullet-points dealing with asset segregation in the event of a SIPC proceeding; (ii) a March 2008 document entitled "Customer Asset Protection Overview"; and (iii) a background memorandum prepared by an outside law firm at LBI's request addressing generally the issue of the safety of assets in brokerage accounts from a regulatory and historical perspective.¹¹⁵ LBI provided these materials to employees to send to clients expressing concern about their assets at LBI in light of LBHI's financial predicament.¹¹⁶

168. Additionally, on March 27, 2008, LBI created a document titled "FAQ Regarding Safety and Soundness of Client Accounts," which was designed for internal use "for purposes of general discussions with IMD clients in response to frequently asked questions relating to asset protection issues."¹¹⁷

114.*Id.*

115.Safety of Cash and Securities Held in a Brokerage Account (Apr. 2008) [LBI_PIR_000288] (attached to e-mail dated Sept. 12, 2008 [LBI_PIR_000007]); Safety of Cash and Securities Held in a Brokerage Account (Sept. 2008) [LBI_PIR_000297] (attached to e-mail dated Sept. 9, 2008 [LBI_PIR_000005]).

116.*See* E-mail dated Sept. 12, 2008 [LBI_PIR_000011]; e-mail dated Sept. 12, 2008 [LBI_PIR_000012].

117.Lehman Brothers, FAQ Regarding Safety and Soundness of Client Accounts (Mar. 27, 2008) [LBI_PIR_000099] (attached to e-mail dated Mar. 27, 2008 [LBI_PIR_000002]).

169. The document addressing asset segregation sought to allay customer concerns about the safety of their assets and the significance of a SIPC proceeding by making positive statements with respect to asset protection, including:

- (i) “[i]f Lehman Brothers were to suffer a deficiency in capital, the SEC and FINRA authorities would immediately step in and ensure an orderly transfer of client assets to other financial institutions”;
- (ii) a discussion of Lehman’s membership in CAPCO concluding that “CAPCO provides coverage on customer accounts up to the account’s net equity for securities and cash held at the brokerage firm, subject to similar terms and conditions on SIPC”;
- (iii) “[i]nvestments in Lehman Brothers Cash Deposit Accounts are insured by the FDIC for up to \$100,000 for individuals, up to \$100,000 per joint owner for joint accounts, and for certain IRA and self directed retirement accounts up to \$250,000”; and
- (iv) “[i]n the event of a SIPC liquidation, SIPC states on their website that most customers can anticipate receiving their funds and securities in one to three months.”¹¹⁸

170. LBI provided the March 2008 document, titled “Customer Asset Protection Overview,” to PIM clients. This document summarized protections available to LBI’s customers and highlighted LBI’s and LBHI’s credit-worthiness, particularly their high credit ratings on long term senior debt from Fitch, Moody’s and Standard & Poor’s. While the

118.*Id.*

document states that it was not intended to be used as legal advice, it also provides an overview of Financial Responsibility Rules including a summary of the cash reserve account as well as the “Rehypothecation Rules” governing when a broker-dealer can commingle client securities with other customer funds.

171. The memorandum focused on descriptions of Rule 15c3-3, the uniform net capital rule (Rule 15c3-1) and customer claims and rights in a SIPA proceeding. It also highlighted the historical rarity of large brokerage firms getting into financial trouble:

In SIPC’s first 36 years of operation, in administering the liquidation of about 320 broker-dealers, the largest net advance in a single liquidation proceeding was \$42.1 million. In all of these proceedings SIPC was required to pay out, on a net basis, only \$322 Million in order to make possible the return of \$15.7 billion of customer property, satisfying nearly all claims of public customers. This reflects two key facts – first, that SIPC liquidations have all involved small brokerage firms, and second, that the operational processes at brokerage firms result in substantive compliance with the financial responsibility and recordkeeping rules so that customer property is properly identified and customer accounts are accurate. Finally, it reflects the fact that in the rare instances in which a larger brokerage firm gets in financial trouble, these rules and the reports given to SEC and FINRA (and to senior management of that firm) have given sufficient early warning so that the problem can be addressed either by infusion of capital or by arranging account transfers before liquidation of the brokerage firm is needed.” (emphasis added).¹¹⁹

172. In September 2008, as LBHI’s financial condition became increasingly precarious, LBI sent these materials to a number of its clients. Moreover, LBI employees sent correspondence to clients to reassure them that their money would be unaffected by what might happen to LBHI. For example, in a September 12, 2008 letter, a Lehman employee wrote, “[o]ur clients investment holdings are 100% segregated from Lehman Brothers holdings.”¹²⁰ And a

119. Safety of Cash and Securities Held in a Brokerage Account (Apr. 2008) [LBI_PIR_000297] (attached to e-mail dated Sept. 12, 2008 [LBI_PIR_000067]).

120. E-mail dated Sept. 12, 2008 [LBI_PIR_000012].

July 22, 2008 email between two Lehman employees that was forwarded to a client on September 12, 2008 reads in part:

The securities in the client's account are solely their property. They are not on Lehman Brothers balance sheet and cannot be used to operate our business or satisfy the claims of creditors. Client assets are separately segregated and held in electronic form at Depository Trust Corporation. Even if the firm failed, creditors would not be able to take client assets to cover unpaid debts. Our clients, like clients of banks/trust companies, have the right to reclaim securities regardless of any creditor claims because client assets are not considered assets of the firm.¹²¹

173. Some communications erroneously suggested that clients could direct DTCC to send specific securities reflected in their account when in fact, absent an account transfer, securities not in a customer's name become part of the fund of customer property, and the client's claim is to a pro rata share of customer property based on the determination of the client's equity in the customer claim process. Communications such as these may have contributed to the confusion and misunderstanding of some customers in the early days of the liquidation.

VI. ADDITIONAL INFORMATION ON FOUR ITEMS RELATING TO LBI MENTIONED IN THE EXAMINER'S REPORT

174. As previously indicated, the Examiner expressly omitted a detailed analysis of matters exclusively related to LBI, in deference to the mandate of the Trustee. However, the Examiner's Report does reach certain conclusions that touch upon LBI and that the

121. E-mail dated June 22, 2008 [LBI_PIR_000006]; *see also* e-mail dated Sept. 12, 2008 [LBI_PIR_000014] ("As a regulated broker-dealer, the firm is subject to various SEC rules and regulations that protect customer assets held with Lehman Brothers in the unlikely event of insolvency. Most importantly, the rules require that customer securities and excess margin securities be segregated from the the [sic] securities that the firm owns. These securities may not be used in any way by a broker-dealer in its business and are not comingled on Lehman's balance sheet. All client assets are held at a Depository Trust Company in NY and they would send these securities to another firm or account as directed by the client.").

Trustee's professionals have investigated further from LBI's point of view. Comments based on this investigation are outlined further here.

A. Potential Avoidance Actions — Below-Market Trades

175. The Examiner analyzed various transfers in connection with potential avoidance actions. In the course of that analysis, the Examiner collected trading data seeming to show that Lehman entities received substantially less than market prices for various securities. In particular, the Examiner located 29 trades between LBI and Citi in which LBI apparently received 10 cents on the dollar for FNMA and FHLMC bonds that were trading at or near par. Initially, it appeared that LBI may have executed the trades with Citi for other Lehman entities, including certain of the Chapter XI debtors. Upon further review, the Examiner reached the conclusion that the trades likely involved only LBI and Citi, and not the Chapter XI debtors, and referred the LBI/Citi trading information to the SIPA Trustee.

176. The value of these trades is approximately \$20 million. The Trustee's professionals have reviewed these trades and concluded that the assets at issue were TBAs owned by a hedge fund client and held by LBI as custodian. These transactions were actually transfers from LBI in a custodial capacity to Citi, which also serves as an alternative prime broker for the customer. The customer instructed that the assets be transferred because of LBI's then-tenuous position. In order to record the transfers in LBI's system, LBI had to enter a transaction price even though there was no price involved with these transfers. Therefore, LBI used the lowest price that the system would accept, which was \$10 per transaction. These transactions did not clear prior to September 19, 2008, and were cancelled after that date. Even if the transactions had cleared, there would not have been any economic impact to LBI or any of the other parties involved, since there was no intended trade but simply a transfer of custodied property.

B. The SEC Never Granted Approval For The Release Of Customer Funds

177. The Examiner's Report suggests that, in connection with the Asset Purchase Agreement ("APA") as between LBI and Barclays, the SEC approved a release from LBI's Customer Reserve Accounts to pay Barclays. The Examiner's Report does not cite any statement made by the SEC, only (i) a September 20, 2008 email from Lehman's Paolo Tonucci, which requests that Mike Macchiaroli of the SEC agree to release excess from the Customer Reserve Accounts, and (ii) the testimony of Daniel Fleming, a former LBI employee, regarding that email.¹²²

178. In fact, the Trustee's necessarily more intense investigation of this particular point demonstrates that the SEC refused to approve the release of any Customer Reserve Account assets.¹²³ Barclays' conduct following the closing of the sale transaction indicates that its representatives understood that regulatory approval was a necessary condition of any transfer. A Barclays' representative has testified that Barclays met with the SEC in an attempt to obtain permission to release supposedly "excess" amounts from the Customer Reserve Accounts, and that the SEC refused to release any assets because of questions regarding the reliability of the computation.

122. See Examiner Report at 2182, n.8054 (citing e-mail from Paolo Tonucci, Lehman to Mike Macchiaroli, SEC (Sept. 20, 2008)); n.8055.

123. See Blackwell Tr. 206:21-208:21, BCI Ex. 56; see also Declaration of William R. Maguire in Support of the Trustee's Motion for Relief Pursuant to the Sales Order or, Alternatively, For Certain Limited Relief Under Rule 60(b), Ex. 30 (LBI Docket No. 1692) ("[the SEC] want[s] to see the info once the reconciliation break has been resolved, and want to ensure that all customer balances [were] moved cleanly").) See also The Trustee's Memorandum in Further Support of His Motion for Relief Pursuant to the Sale Orders, or, Alternatively, for Certain Limited Relief Under Rule 60(b) and In Opposition to the Motion of Barclays Capital Inc. to Enforce the Sale Orders and Secure Deliver of All Undelivered Assets, 19 n.6 (LBI Docket No. 2847).

C. Repo 105/108

179. In addition to traditional repo transactions, LBHI engaged in “Repo 105” and “Repo 108” transactions through LBIE, so named for their intended minimum haircuts of 105 and 108 percent for fixed income and equity related collateral, respectively. These transactions enabled LBHI to manage its balance sheet through netting opportunities. As discussed at length in the Examiner’s Report, LBIE received a “true sale” opinion from a law firm in the U.K., and thereafter accounted for such repos not as financings (as would be the correct treatment for a typical repo transaction), but rather as “true sales” of inventory and forwards to repurchase securities.¹²⁴ As a result, LBIE accounted for the transactions as sales, rather than financings, and thereby shifted the repo’d assets away from its balance sheet. LBHI benefited from the results of this accounting as LBIE was consolidated with LBHI for accounting purposes.

180. The Trustee and his professionals have investigated, and continue to investigate, whether LBHI’s use of Repo 105 and Repo 108 transactions was intended to or did in fact benefit LBI, and whether such transactions adversely impacted LBI in any manner. Based upon the investigation to date, it appears that each of these questions can be answered in the negative, with the potential exception that LBI appears to have received the same haircut on these transactions that LBIE ultimately received from third parties.

181. In the normal course of broker-dealer financing, as discussed above, LBI frequently engaged in repo transactions with Lehman affiliates (including LBIE) as well as third parties, through which LBI tendered securities in exchange for financing. In certain instances,

¹²⁴Examiner’s Report at Section III.A.4.

LBI engaged in repo transactions of securities with LBIE, which securities LBIE may ultimately have used to engage in Repo 105 transactions. From LBI's perspective, however, LBIE's ultimate use of such securities in a Repo 105 transaction had no impact on LBI from a financial reporting standpoint. The only potential negative impact on LBI was that LBI apparently received the same terms (*i.e.*, haircuts and interest rates) from LBIE that LBIE received from the ultimate counterparty. LBI booked its repo transactions with LBIE no differently from typical repo financings. In fact, because LBI did not have a "true sale" opinion with respect to the accounting treatment for these transactions under U.S. Generally Accepted Accounting Principles, LBI could not benefit from the type of accounting employed by LBIE for these repo transactions. Consequently, LBI could not improve its balance sheet by participating in a Repo 105 transaction, and such transactions did not impact LBI's balance sheet any differently from a typical repo financing for like securities. Furthermore, LBI's regulatory personnel recognized that no benefit would inure to LBI from Repo 105 transactions, and might even be problematic from a regulatory compliance perspective.

D. HSBC Deposit

182. The Examiner's Report contains a section discussing a \$1 billion segregated deposit that LBI maintained at HSBC.¹²⁵ Based on an interview with HSBC's Global Relationship Manager for Financial Institutions, the Examiner's Report states that "LBI kept this deposit with HSBC to satisfy the net capitalization requirements of broker-dealers under Rule 15c3."¹²⁶ According to the HSBC employee, although HSBC had "expressly waived its right of setoff" with respect to the deposit and the deposit was "technically unencumbered," Lehman was

125.Examiner's Report at 1312-14.

126.*Id.* at 1313.

“required to provide notice to HSBC before making a withdrawal.”¹²⁷ The HSBC employee is reported to have further stated that “sometime post-petition in September 2008, Lehman directed HSBC to deliver the deposit to Barclays and that HSBC complied with the request.”¹²⁸ The Examiner noted that, “[a]ccording to Lehman’s internal memoranda, LBHI did not include this deposit as part of its liquidity pool.”¹²⁹

183. The Trustee’s financial professionals have reviewed LBI’s books and records concerning this deposit and determined that those records do not support several aspects of the HSBC employee’s reported description of the deposit. To the contrary, LBI’s records indicate that the deposit was maintained for customer segregation purposes, but not as part of a reserve for customers pursuant to SEC Rule 15c3-3. LBI’s records show that the deposit was withdrawn before the sale to Barclays closed, but do not show that the deposit was transferred to Barclays. Furthermore, LBHI was not able to include the deposit as part of its liquidity pool because, from a regulatory perspective, the deposit was considered an encumbered asset.

VII. CERTAIN CHALLENGES OF THE LARGEST BROKER-DEALER LIQUIDATION IN HISTORY

184. In this section of the Preliminary Report, the Trustee presents lessons learned and some recommendations for consideration in preparing for and conducting a future liquidation of any major broker-dealer, whether through a standalone SIPA proceeding before or after account transfers or as part of a broader effort involving the FDIC and others under the orderly liquidation authority provided for in the new financial reform legislation. The problems

¹²⁷.*Id.*

¹²⁸.*Id.* at 1313-14.

¹²⁹.*Id.* at 1314.

identified here arose from the unprecedented size, scope and international ramifications of the Lehman liquidation, the hurried and tumultuous environment in which the SIPA proceeding had to be commenced, and the absence of a full understanding of, let alone planning for, how the interests of customers that would remain with the soon-to-be-liquidated estate would be affected by the constantly evolving series of transactions actually implemented. When the storm subsided, it emerged that the transactions involved only a partial transfer of accounts, with the interested regulatory authorities and the Trustee struggling to understand and gain control of the customer property and potential customer claims that were left behind.

185. The situation that resulted led not only to disputes that are still being negotiated or litigated but also to unanticipated difficulties in obtaining access to customer property and records, including customer assets and records located abroad, and records obtained by Barclays in the partial sale transaction. It also created complicated relationships with the Chapter XI Debtors, Barclays and others which have impeded access to information and people knowledgeable about LBI's operations.

A. Overview: Evolving Events Hinder Careful Planning

186. Originally, Lehman management planned to save the firm without the need for insolvency proceedings by raising capital, selling the IMD business and spinning off some of the more troubled assets. The plan then changed to finding a buyer that would buy all or most of the enterprise. When a sale to Barclays failed for lack of shareholder approval or a guarantee by either industry participants or the government, the plan changed to an orderly wind-down orchestrated by the FRBNY. The wind-down was, in fact, not orderly, in part because of the unanticipated effect LBHI's Chapter XI filing had in cutting off cash flow and forcing LBIE into administration, thereby freezing many transactions with LBIE. Market participants also lost confidence in Lehman as a whole even though LBI, its U.S. broker-dealer, was in much sounder

condition and appears to have been largely in compliance with the customer protection requirements until near the end. As the wind-down got underway, Barclays reappeared to purchase at nominal cost much of the remaining U.S. brokerage business and assume many — but far from all — of the remaining customers' accounts in a frantically negotiated, much disputed and less than pellucid set of agreements.

187. The Trustee is or may become a party to litigations and disputes involving these transactions and events. It would therefore not be appropriate and is not the aim of this Report to cast blame or to comment on the merits of issues to be determined by the courts. One thing that subsequent developments have made abundantly clear, however, is the unnecessary extent of difficulties caused by the fact that the SIPA proceeding was conceived of as something of an afterthought to a forward-looking transfer of businesses and accounts to Barclays on the one hand and reorganization of LBHI on the other. The SIPA liquidation was to be the vehicle for completing the transfer of Neuberger Berman accounts and transferring what were said to be the large bulk of remaining accounts to Barclays. Relatively little advance attention was given, however, to the scope or conduct of the SIPA proceeding itself.

188. Originally it was believed that there would be few significant non-transferred accounts and that the customer aspects of any SIPA proceeding would be concluded quickly. There was, however, no real planning or exchange of information about the scope of the operations to be transferred, nor was there any clear definition of exactly which customers and what customer property would remain with LBI to be dealt with in the SIPA proceeding.

189. No advance planning had occurred with respect to how the liquidation of the shell of the broker and its remaining proprietary and customer assets and accounts would work in practice: (i) how effective access would be obtained to books, records and systems

transferred to Barclays' control; (ii) how the informational and operational needs of a Trustee now faced with tens of thousands accounts to transfer or examine would be integrated with the needs of the LBI subsidiaries spun off to the holding company on the eve of the SIPA filing; (iii) how records and facilities would be shared and made available to the Trustee for the parts of the business that stayed behind as tens of thousands accounts and related records were being acquired by Neuberger Berman on the one hand and Barclays on the other; or (iv) how the customers and customer accounts that were located in Europe and cleared through an omnibus account between LBI and LBIE would be administered with LBIE already in administration under a different foreign insolvency regime. A hastily-drafted (and, in retrospect, far from satisfactory) transition services agreement was executed between LBHI and Barclays when the Barclays transaction closed on September 22, 2008, but neither LBHI, which had been acting for LBI prior to the Trustee's appointment, nor Barclays considered the implications for LBI (which was not even a party to the agreement).

190. In addition, LBI maintained accounts at banks and depositories around the world through which it held securities for its customers. Following the commencement of LBHI's and LBIE's insolvency proceedings, many of these banks and depositories ceased providing information on the positions in these accounts. Though customer claims are determined using LBI's records of what it was holding on behalf of its customers, sourcing securities and cash to fund allowed claims is dependent on the access provided by the custodial banks. Because this access was either incomplete or denied, the Trustee was unable in the early periods of the liquidation to determine to what extent securities known to be needed for account transfer or for inclusion in the fund of customer property were actually available. After substantial effort and work with these depositories, the Trustee has been able to gain access to

information about LBI's custody accounts. The process, however, has resulted in complications and delay of the account transfer and customer claims resolution efforts, and, in some cases, has caused problems in obtaining property believed to be safely custodied for customers.

B. Transfer vs. Non-Transfer Of Customer Accounts: Legal And Practical Implications

191. The legal and practical consequences of decisions regarding transfer or non-transfer of accounts in a SIPA proceeding are significant. As amended in 1978, SIPA contemplates as the default option the creation of a "Fund of Customer Property" in which "Customers" (as defined in the statute) share pro rata, based on their "Net Equity" — essentially the net amount owing by the broker if all positions were liquidated as of the filing date. SIPA § 78III(2), (4), (11). This approach contemplates a marshalling of assets and a claims determination process involving two estates or pools of property to liquidate — one consisting of customer property and claims, and another for non-customer creditors.

192. A complementary regulatory scheme reflected in the SEC's "Customer Protection" rules, principally Rule 15c3-3 under the Exchange Act, seeks to assure that the SIPA trustee will find the property necessary to satisfy customer claims close to hand: cash obligations will be covered by deposits in a Reserve Account set aside for the exclusive benefit of customers, while fully paid customer securities will be securely held in good control locations, segregated from non-customer property and immune from seizure to pay debts of the broker dealer. This regulatory scheme was largely created during the early 1970's, and was reflected in the 1978 amendments to SIPA. In addition, the Uniform Net Capital Rule, SEC Rule 15c3-1, is designed to ensure that the firm has sufficient liquid assets to permit an orderly liquidation. The objectives of this scheme are to protect customers both while the broker-dealer is in operation and as it enters liquidation either with or without an account transfer.

193. The 1978 Amendments to SIPA also formally introduced a trustee's authority to transfer customer accounts to a solvent SIPC member. The SEC customer protection rule makes this a viable solution as long as the failed broker has complied to a sufficient extent and has maintained accurate books and records. Thus, the 1978 SIPA amendments provided that, "subject to the prior approval of SIPC," the Trustee could, "without the consent of any customer, sell or otherwise transfer all or any part of the account of a customer of the debtor to another member of SIPC." SIPA § 78fff-2(f). The legislative history of this section referred to the advantages of such a process, in contrast to the claims-based approach. The principal advantages are speed and prompt restoration of customer control of their investment accounts, which have always been key goals of SIPA.¹³⁰

194. The Trustee's extensive use of the customer account transfer authority greatly mitigated the impact of Lehman's failure on the vast majority of LBI and Neuberger Berman customers as well as many prime brokers — and indirectly for the market as a whole. As set forth in detail in other sections of this Report, however, the inability to transfer important categories of accounts — the extent of which was never discussed (or, to the Trustee's knowledge, considered in a systematic way) — produced unforeseen consequences in many aspects of the liquidation. These consequences were exacerbated by Barclays' post-liquidation decision to reject the entire PBAs range with property and liabilities to customers well in excess of \$5 billion.

130. *See Securities Investor Protection Act Amendments of 1975: Hearing on H.R. 8064 Before the Subcomm. On Consumer Protection and Finance of the H. Comm. on Interstate and Foreign Commerce, 94th Cong. 56 (1975)* (SIPC Chairman Hughes remarked to Congress, "One of the principal goals of the proposed [amendment to SIPA] is to make it possible for the trustee to render accounts to customers as they stood when the firm failed. One way to accomplish this in very rapid order is to empower the trustee to transfer accounts in bulk to another broker/dealer.")

C. Incorrect Assumptions And Unanticipated Impediments

195. The Trustee was appointed after LBHI's and LBIE's insolvency proceedings had already been instituted and with agreements already drafted and transactions, such as the sale of virtually all of LBI's subsidiaries, already in place.¹³¹ The Trustee had no independent access to records or personnel and was provided only rough, high-level estimates both about assets that had already been divided up among other parties and about what was left behind at the broker. The implicit assumption — which proved to be optimistic at best — was that most customer accounts and related assets would be transferred smoothly and easily and that only a relatively trivial number of customers and limited amount of customer property would need to be dealt with in any SIPA claims process.

196. These assumptions proved to be incorrect for a number of reasons, many of which have been described in more detail at the beginning of this Report. Operationally, the transfer of customer assets was anything but smooth because of, among other system limitations, shutdown of account access screens by clearing banks and other organizations, lack of access to records, frozen overseas accounts, the functioning of the DTCC system, including reversal of the ACATS transfers,¹³² lack of clarity in the purchase agreement and simple human confusion as employment relationships and job functions changed.

197. These problems produced frictions and enormous added costs that might have been avoided by advance planning and analysis as well as more time to adjust assumptions

131. Contrary to statements by LBHI in its disclosure statements [cite], the Trustee never specifically consented to the transfer of subsidiaries. The Trustee was informed about them in a telephone conversation with LBHI's counsel but had not even been appointed when this call occurred. Representatives of LBI advised by others, not the Trustee, voted for and executed the transaction. Trustee's Third Interim Report at ¶ 109, n.13.

132. See Section V.A.4.

to reality. Fortunately, thanks to the tireless efforts of many professionals and some former LBI personnel, no obstacle was significant enough to derail the transfers as a whole — though it was not always clear that this would be so. The process of transferring property through intermediaries without being a viable broker-dealer with an ongoing operation took time and expense to implement and met with hesitancy, uncertainty and sometimes prolonged refusal from market participants. At an operational level, the transfer or registration of tens of thousands of separate securities, mutual funds, money market funds, and other investment products proved to be filled with unexpected hurdles. These were time consuming to resolve and ultimately delayed the actual transfer of property.

198. One example was the Trustee’s lack of full and immediate access to records and computer screens and systems normally available to a broker-dealer as discussed above with respect to JPMC.¹³³ Similar problems were initially encountered at DTCC, which did not provide access to screens for the first three weeks of the liquidation.

199. Another example was the Trustee’s lack of medallion authority for transferring physical securities. Shortly after September 19, LBI’s “medallion guarantee” expired. In the securities industry, medallion stamps guarantee signatures on documents associated with the ownership, registration, and transfer of securities. The purpose is both to protect the securities’ holders by limiting fraud and also to limit the liability of those acting or relying on transfer instructions. Before issuing a medallion stamp, the three programs that provide medallion stamps require their “members” to post a cash bond, obtain insurance, and/or

133. *See supra* Section V.A.4.

provide an indemnity associated with reliance. These protective measures allow those relying on a medallion guaranteed signature recourse should the guaranteeing party fail to perform.

200. Historically, LBI had been a member of the New York Stock Exchange's "Medallion Signature Program." When LBI's medallion expired, the Trustee was unable to obtain renewal of the medallion under reasonable terms. The NYSE's administrators demanded the posting of a bond equal to the value of the largest security to be transferred (at the time at least \$150 million). Left in the paradoxical position of being charged with the transfer of securities to LBI's former customers but lacking the operational tools to do so, the Trustee relied on third parties or receiving parties to provide the medallion guarantee for his representatives' signature. In instances where Barclays or Ridge was not the receiver of the transferred accounts and the related assets, DTC required (and still requires) that the Receiving Broker complete and medallion-stamp a form agreement indemnifying DTC with respect to the transfer of the securities for the benefit of a prime brokerage customer. The result was often that, while the Trustee was prepared to transfer the assets in an account, the customer's new broker-dealer was unable or hesitant to complete required transfer paperwork. Ultimately the customers were able to convince their new brokers of the need to complete the paperwork, but these operational issues caused delays of days, if not weeks in some cases.

201. The Trustee's subsequent attempt to join the Securities Transfer Agents Medallion Program ("STAMP") was also unsuccessful. The Trustee was unable to obtain the insurance sponsorship and policy, or to provide the extent of indemnification, required for participation in STAMP.

202. Changes within SIPA could readily eliminate some operational hurdles. As one alternative, SIPA could guarantee the trustee's signature with respect to transfer agents,

specifically authorizing their reliance. When faced with an unwilling transfer agent, the trustee could direct a transfer agent to this provision. Alternatively, SIPA could directly authorize the trustee to obtain a medallion stamp and provide a guarantee from the SIPC fund as an alternative to the regular insurance demanded by medallion administrators.

203. These are merely some examples of delays, inefficiencies and adverse impacts to the customers and creditors from the Trustee's lack of the same access to the system information and industry relationships that LBI had as a functioning broker-dealer. The challenges the Trustee and his professionals faced were largely invisible to the customers whose accounts were treated as intact despite delays in transmissions of property. As will be noted, this was in itself a signal feature of this liquidation and a testament to the manner in which SIPA serves its key purposes, even in the most strained and unforeseen of circumstances. But it does not mean that improvements could not be made for future proceedings.

D. The Customer Accounts Included In The SIPA Proceeding

204. Initially, in addition to the effort to effect the Neuberger Berman and Barclays account transfer, the Trustee was confronted with thousands of major customer accounts that remained with LBI. These fall into four major categories. Together they filed claims aggregating over \$65 billion, which, even after eliminating obvious duplicates and denials, claims against the wrong entity, and the like, amount to \$35 billion to \$40 billion of claims. While allowed amounts will be much less, these claims have had to be analyzed, researched, formally determined, objected to, discussed at length with claimants, and in many cases litigated. As described below, a liquidation of any one of these categories of accounts, let alone all four, would in itself exceed any previous SIPA or broker-dealer liquidation.

1. Prime brokerage assets

205. One significant contributing cause to the increased size and complexity of the SIPA liquidation was the decision communicated by Barclays on September 29 — ten days after the liquidation commenced and more than a week after finalization of the clarification letter to the APA — that it would not assume control of the prime brokerage accounts. This position surprised the Trustee, SIPC and regulators, and surprised even some of the Barclays-employed personnel involved with these accounts. The rejection of these accounts by Barclays left the Trustee with additional large, complicated accounts to administer, determine and distribute with filing date values far in excess of \$5 billion — enough in itself to dwarf any previous SIPA or brokerage liquidation, save perhaps that of MJK Clearing, Inc. (“MJK”). The innovative account transfer protocol which the Trustee implemented with SIPC and regulators, and which was effectuated pursuant to the flexible account transfer provisions of SIPA, allowed for the return of substantial amounts of property to account holders before the claims process began.

206. This unanticipated prime brokerage account transfer protocol procedure was nevertheless logistically difficult, consumed resources that could have been devoted to other purposes, and was undoubtedly less satisfactory to the account holders involved than a purchaser’s outright assumption of accounts would have been. Many accounts could not be transferred in their entirety because of potential liens in favor of other entities, property that was temporarily unavailable or tied up in the LBIE insolvency proceedings, disputes about legal or factual issues, or because account holders chose not to participate. Without a single destination broker-dealer for all the accounts, many of the prime broker account transfers were only partial. As a result, over a thousand claims of prime brokerage account holders have had to be handled through the claims process. They present in some cases complex legal issues and claims that may not be eligible for SIPA treatment. They are now the subject of formal claims objections,

amounting to several billion dollars, which will in many cases have to be determined through litigation and appeal. Much of this effort and uncertainty could have been avoided had the accounts been assumed by Barclays as originally expected.

2. The unknown universe of non-PIM, non-PAM accounts

207. Many other LBI accounts remained with the Trustee because they were neither in the PAM range acquired by Neuberger Berman nor the PIM range acquired by Barclays. When the Trustee first took control of LBI, there was no definition of which accounts were left behind. The Trustee's professionals received estimates of a few hundred legacy Shearson Lehman or friends and family accounts as well as many thousand RVP/DVP accounts. The Trustee did not know the size or composition of this miscellany of customer accounts that would remain behind until the claims filing deadline had passed.

208. The Trustee has in fact received over 8,000 claims from a variety of individuals, companies and institutions. Some of these claims relate to accounts that were not in the PIM or PAM range and were not attractive to Barclays for several possible reasons. Many accounts were maintained in a separate account range for primarily non-trading, custodial accounts for large corporations and institutional clients for which Lehman did underwritings or other types of transactions. Many others were maintained in separate account ranges for clients who wished to trade in non-traditional products such as TBAs (so called "MTS Accounts" because of the system on which they were maintained) and F/X trades (so-called "ITS" Accounts). Although many claims were incorrectly asserted against LBI, duplicated others, or were for empty accounts, nearly 700 claims have so far been determined to be allowable with a value of over \$2 billion. None of these accounts was considered a PIM- or PAM-range account, and Barclays did not acquire them. Over 1,300 objections to the Trustee's adverse

determinations have been filed, though approximately one hundred have already been withdrawn or denied by Court order.

209. To be sure, these claims may seem to be a relatively small part of the LBI customer universe that existed on the filing date. But in any other context, the perception would be much different. Administering a claims population of this complexity and with claims of this magnitude is a far from trivial exercise. No prior SIPA proceeding has involved anything close to the dollar amounts of customer property and customer claims in issue. The next largest, MJK, involved less than \$1 billion of allowed claims and customer name securities returned to customers, in addition to \$10 billion in account transfers.

3. The LBIE clearing and house customer accounts

210. A third source of customer claims, which have not yet been determined, derives from the undisclosed clearing arrangement and corresponding omnibus accounts that LBIE maintained with LBI on behalf of over a thousand large, primarily hedge fund accounts as well as on its own behalf. LBIE filed a claim totaling over \$12 billion on behalf of itself and the underlying clients to this omnibus account. (Some of the clients filed their own claims as well, and some have contended that they should be considered direct customers of LBI despite the records to the contrary and their treatment for regulatory purposes.) A substantial reconciliation effort between the professionals at PricewaterhouseCoopers (“PwC”), which serves as LBIE’s administrators, and Deloitte, the Trustee’s financial professionals, has been underway for many months and is now nearing partial conclusion. The difficulty of the task is complicated by the fact that LBIE’s books closed on or before September 15, after the LBIE insolvency proceeding began, while LBI’s SIPA filing date was September 19 and its accounts were open through the

intervening week, when over 100,000 “failed to deliver to LBI” trades and over 95,000 “failed to receive from LBI” trades were booked or settled with counterparties.¹³⁴

211. The LBIE customer claim exercise alone should be compared to the next largest clearing broker SIPA liquidation, that of Adler Coleman Clearing Corporation. That liquidation involved a final allocation of \$759.5 million to customer property, less than ten percent of what has been claimed by LBIE and a small fraction of what the allowed amount is likely to be. And the Adler Coleman liquidation did not involve the complicated and unprecedented jurisdictional and other issues attributable to the nature of the agreements and trading strategies of the clients, LBIE’s status as a broker-dealer operated and being liquidated under a foreign nation’s regulatory and insolvency regimes and the wide array of products at issue in the LBIE account.

4. The affiliate customer claims

212. Finally, LBI affiliates, principally LBHI and other Chapter XI entities, have asserted over 650 customer claims totaling over \$19 billion. These include claims by some of the subsidiaries that were transferred out of LBI mere hours before the SIPA Proceeding began. The Trustee believes that many of these accounts are subordinated by agreement, by understanding, or by operation of law or otherwise are not eligible for customer treatment or subject to reduction for an affiliate’s indebtedness. Some, however, may be on behalf of underlying clients and may involve property subject to customer segregation rules, and may therefore be allowable as customer claims. Indeed, three claims on behalf of one LBHI affiliate

¹³⁴. See Trustee’s Third Interim Report at ¶ 23.

(Woodlands Bank, f/k/a Lehman Brothers Commercial Bank), totaling over \$500 million, have already been allowed.

213. The LBHI and other affiliate customer claims represent yet another unexpectedly significant claims population in terms of amount of property involved and potential complexity. These claims were explicitly removed from the transaction only in a draft of the so-called clarification letter to the APA circulated a few hours before the closing on Monday, September 22, 2008.

E. The Largest Broker-Dealer Liquidation Ever

214. In short, what may have been conceived of as an incidental customer claims liquidation proceeding has in effect resulted in a liquidation involving four sets of claim groups — the prime brokerage accounts; the miscellaneous non-PIM, non-PAM customers of LBI; the LBIE omnibus account; and the LBHI and other affiliates' accounts — any one of which could qualify by itself as the largest SIPA liquidation ever. To these substantial claim proceedings must be added general estate claims filed in amounts exceeding \$60 billion. These aspects of the claims process have proceeded in combination with the largest customer account transfer in history, the return of over \$520 million in misdirected funds and pursuit of recoveries from counterparties so far totaling over \$2.7 billion, as well as efforts to recover or reduce to the Trustee's control billions of dollars of cash and securities. LBI was also at the center of a web of transactions with other LBHI companies, including its own former subsidiaries, which suddenly came to an end in various stages of execution. LBI's position in the Lehman enterprise has entailed substantial potential claims among administrators requiring reconciliation and analysis and has led to an average of ten subpoenas and document requests per week from third parties and regulatory authorities. In addition, as of the filing date, hundreds of counterparty transactions, such as repos, stock loans, foreign exchange, and OTC options, remained open.

**F. SIPA And The Customer Protection
Rules Scheme Largely Worked Well In Spite Of It All**

215. Despite these unanticipated developments and other difficulties addressed below, one of the untold stories of the demise of Lehman is the degree to which SIPA worked and protected most customers' accounts. While the Trustee has identified some issues with LBI's regulatory compliance, largely in the late stages of its existence, to a large degree the Financial Responsibility Rules proved effective. Most customer property was relatively intact. Even numerically significant dollar shortfalls in amounts available to customers, should they eventuate, would be a small fraction of the over one hundred billion dollars of customer property that existed on the filing date. (A significant portion of any such shortfall, should it eventuate, would result from property taken by Barclays or appropriated by secured lenders or depositories as collateral, differences in the manner in which some transactions or accounts may be treated for regulatory as opposed to SIPA purposes, and difficulties in accessing property in overseas locations that were considered "good control" locations for regulatory purposes but in fact became tied up in foreign insolvency proceedings with rules of their own.)

216. Most importantly, the vast majority of direct LBI unaffiliated, public customer accounts — more than 110,000 accounts encompassing approximately \$89 billion in value — have been transferred. Despite operational difficulties, customers were almost universally able to resume trading in those accounts seamlessly and within days, avoiding loss, eliminating confusion and anxiety and avoiding further disruption of the capital markets beyond that caused by the failure of the rest of Lehman Brothers and the near-failure of other leading financial institutions. In addition, a substantial majority of property in the PBAs — a type of account never envisioned when SIPA was created or last amended — totaling more than

\$3 billion could be returned to clients through other financial institutions using an innovative protocol made possible by the SIPA account transfer provisions.¹³⁵

217. Even in an environment of a partial takeover of customer accounts, with constant disputes with Barclays and affiliates over access to systems and shared resources and over the meaning of the basic contractual documents, with depositories limiting access to screens, with lack of direct access to LBI personnel familiar with the broker-dealer's business and systems, and with the world in financial turmoil and confused about the nature and interdependency of the Lehman insolvency proceedings around the world in a liquidation begun on a triple-witching day, SIPA worked remarkably well, thanks largely to the cooperative efforts of the Trustee, SIPC, the regulatory authorities, and their many skilled and dedicated professionals.

VIII. SOME LESSONS AND CAUTIONARY TALES

218. That SIPA worked well for so many customers does not mean that it worked perfectly against the limitations imposed by the LBHI-Barclays transaction, the conduct of various parties described in this Report, and the operation or administration of U.K. and other foreign insolvency regimes. Proper planning and more notice to and involvement of SIPC and any potential trustee in planning and negotiation might have avoided surprises that delayed and in some cases threatened to frustrate the account transfer and claims processes. More advance planning would have led to clearer demarcations of asset ownership, responsibilities and access to records and systems; focusing on these key details in advance would almost certainly have yielded a sounder plan for correlating available assets with obligations to customers.

135. See Prime Brokerage Protocol; see also Trustee's Third Interim Report at ¶ 16; Trustee's First Interim Report at ¶¶ 25-33.

A. SIPA: More Than An Afterthought

219. No matter what the parameters of a holding company collapse, the needs of customers and the possibility of a SIPA liquidation should be more than an afterthought. The broker-dealer was at the heart of Lehman's operations. Its liquidation and protection of its customers should have been more than a footnote to plans to dispose of its other valuable assets. Indeed, wherever possible, the emphasis should be on arranging customer account transfers even before commencement of SIPA proceeding. When that does not happen, dividing assets and liabilities among a holding company, a trustee for a broker-dealer entity with duties to return property to customers, and an entity acquiring some parts of the brokerage business requires forethought and participation in the public interest both by those who know the brokerage operation and those who will administer its liquidation.

220. What follows are some examples of unnecessary issues and unexpected pitfalls that could be avoided by better planning. We also offer policy suggestions for consideration in connection with any current or future review of the workings of the SIPA statute. Most, if not all, of these suggestions would apply to a liquidation as part of a broader liquidation pursuant to the orderly liquidation authority provided for in the financial reform legislation as well as a SIPA liquidation conducted on a standalone basis or in parallel with Chapter XI proceedings.

B. The Desirability Of Account Transfers And Costs Of Partial Account Transfer

221. One set of problems that has permeated the liquidation has been the partial nature of the Barclays transaction — the sale of some, but far from all, of the customers' accounts together with many other assets and all the books, records and systems associated with

the broker-dealer, only some of whose accounts were transferred.¹³⁶ Without commenting on pending disputes regarding the status and interpretation of the APA and other sale documents, it is fair to state that the negotiation of the asset purchase and resulting agreements suffered from a lack of clarity about what assets and even what customer accounts Barclays was obtaining as part of this partial asset and account transfer. A clearer identification at the outset of negotiations of exactly which customers' accounts would go to Barclays and which would remain with the LBI trustee and the nature of the associated assets would undoubtedly have led to more focused negotiations and more focused agreements. Steps should be required to be taken in advance, not after the fact, to confirm in at least in broad terms the location and availability of the cash and securities to be returned to customers and of the systems needed to maintain visibility into them.

222. Whether terms that might have appeared desirable to assure an effective liquidation that maximized protection for all customers would have been acceptable to Barclays or another purchaser is a moot point. In future liquidations regulators and customer representatives might well insist that an acquirer take all or substantially all accounts or insist on other specific protections for remaining accounts and a Trustee's operational and informational needs. They might insist that the holding company proactively explore account transfers to more than one firm so that maximum protection is afforded customers and maximum value is realized for the transfer. In the Lehman situation, Barclays obtained extremely valuable, high worth customer accounts for an insignificant goodwill payment used to limit its liability and left hedge funds and other accounts behind.

136. Counting the PAM accounts transferred to Neuberger Berman and the accounts Barclays left behind or rejected, Barclays in fact took on less than two-thirds of the accounts in number and fewer than half in claim amount.

223. At the very least, parties representing customer interests should, with the better planning and access to information we recommend, bargain against a clear baseline of what needs to be transferred and avoid subsequent uncertainty and surprises. The Trustee also recommends that a party with potential responsibility for the customers — whether SIPC, a putative trustee or a regulator, or a combination of all of them — be involved in the negotiations. As in Lehman’s case, the seller’s immediate focus is likely to be its own post-transaction survival; the purchaser’s is with the customers and assets it is taking on, not those it is leaving behind. The Trustee also recommends that SIPC be granted increased financial resources, and flexibility to use those resources, so that assistance and protection could be offered to potential acquirers as necessary.

224. Assessing the costs and logistical challenges associated with a liquidation — and particularly one involving a partial account transfer — necessarily involves time and information. In the midst of a crisis of Lehman’s proportions, with demands for immediate solutions, it may be difficult for decision-makers to stand against the tide calling for immediate action in order to inquire into operational and account details. Therefore, as a complement to an industry-wide liquidation planning initiative as detailed below, a potentially useful amendment to SIPA would be a requirement that a minimum set of additional judicial findings be made in the event of partial account transfer. These findings would be designed to ensure that, in the rush to complete a partial transaction, parties pay more attention to the customer population as a whole. The findings would require some showing of the extent of the customer population not being transferred and of the degree of protection those customers would be expected to receive, as well as assurances about available assets, customer property and future access and cooperation. The

parties would be forced to focus before the fact on some of the things that in LBI's case only the Trustee focused on and only after the fact.

225. In the case of LBI, one thing that the Trustee and SIPC were able to focus on was the timing of the settlement process and its possible impact on account transfers and customer claims. Although some assumptions about the expected ease of that process turned out to have been hopelessly naïve, the Trustee and SIPC included a provision in the order that SIPC asked the District Court to enter that allowed trades made before the SIPA filing in the early afternoon of September 19th to be settled through that evening and the close of business on the following Wednesday. In the opinion of the Trustee's professionals, allowing these thousands of trades to settle, even though unexpectedly impeded by the ACATS reversal, allowed a much "cleaner" and, from the customer's viewpoint, intact set of accounts to be transferred and therefore facilitated the account transfer process. Inclusion of such a provision, as well as mechanics of the account transfer process itself, ought to be considered in any future SIPA liquidation in which a significant account transfer process is contemplated.

C. The Information And Operations Gap

226. A related set of problems arising from the partial nature of the transfer was that Barclays acquired all the systems and records as part of the acquisition of assets, while the Trustee was left with insufficient practical access to the same systems. These issues were compounded by the massive number of systems involved (over 2,700) and the fact that other Lehman entities also had needs for data intermingled with the same records.

227. The LBI Liquidation Order was drafted to guarantee access to LBI books and records in any form,¹³⁷ but Barclays argued that the information itself was separate and distinct from access to the Barclays-acquired systems on which the information was housed and also expressed concerns about protection of “intermingled” and possibly confidential information. On a day to day level, many personnel familiar with LBI financials and operations were hired by Barclays; the Trustee was nevertheless dependent on these people for most basic informational and operational services (including even the processing of checks and wires being received into LBI’s own bank accounts).

228. For the first several weeks of the liquidation one person, by then an employee of Barclays, was to be the point of contact for virtually all information requests by the Trustee as well as LBHI. Delegation of authority by this person was limited, the number of urgent competing demands was enormous, and her priorities as a Barclays employee were not always the same as the Trustee’s. Eventually, after several months and numerous complaints by the Trustee and SIPC, a group with a leader was assigned to work at least much of their time on Trustee projects. This group, as well as what became a “ring-fenced” team of Barclays back-office workers, were ultimately provided for in the transition services agreement between Barclays and the Trustee, but requests still had to be centralized and prioritized by Barclays personnel to a frustrating extent. Availability and priorities were not always what the Trustee asked, requests were vetted by representatives of a party with whom the Trustee would have

137. The order provides “that all persons and entities are stayed, enjoined and restrained from directly or indirectly removing, transferring, ... changing, ... or otherwise disposing of, withdrawing or interfering with any assets or property owned, controlled or in the possession of LBI, including but not limited to the books and records of LBI” and “that the Trustee is authorized to take immediate possession of the property of LBI, wherever located, including but not limited to the books and records of LBI. LBI Liquidation Order (**Exhibit B**).

fundamental disputes, and the charges for services provided have been costly, amounting to as much as \$5.2 million a month and nearly \$60 million to date.¹³⁸

229. For many months Barclays would not even permit the Trustee's professionals to have direct access to basic systems, until threats of litigation by the Trustee led the parties to agree to an interim data access agreement entered in February 2009 and approved by the Court on April 22, 2009.¹³⁹ The Trustee's professionals were dependent on Barclays personnel to book all entries and bring the books and records up to date. As they have elsewhere noted, similar problems plagued LBHI and its professionals, even with the protection of the hastily-drafted, pre-filing date transition service agreement.¹⁴⁰

230. While the Access Agreement enabled the Trustee's professionals to have direct access to interactive systems, it was not so for non-interactive systems. Barclays continued to preclude access to the latter on the asserted basis that the non-interactive systems contained co-mingled LBI and post-September 19, 2008 Barclays's data.

231. Even following the Access Agreement, Barclays continued to preclude direct access by the Trustee's professionals to at least two critical systems: PeopleSoft HR, which contains all LBI employee information, and eDoc, which was a report archive repository. Each of these systems was critical to the Trustee's work. Although the Access Agreement provided for access to systems even if they contained co-mingled data, Barclays continued to refuse to provide access to any systems that contained Barclays' data. The Trustee's

138. In recent months these costs have been declining as certain tasks have been completed and the Trustee has ceased to use various systems or migrated them to other sources.

139. Order Pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code for an Order Approving a Systems Access Agreement between Trustee and Barclays Capital Inc. (LBI Docket No. 1018).

140. See Examiner's Report at 1996.

professionals formulated a resolution to the problem by (1) creating a copy of the Peoplesoft HR system that contained only data prior to September 19, 2008, and (2) working with Barclays to use the technical features of the eDoc system to limit the Trustee's access to only those archived reports associated with LBI. Although this resolution was achieved, it was not without significant additional expense and delay to the progress of the liquidation, and serves as an apt example of the unanticipated and complicated data access issues presented in this liquidation.

232. Preliminary efforts to create closing balance sheets and reconciliations — something Barclays' counsel has professed disbelief had not been done immediately during the Barclays litigation — have had to be delayed for many months and still have not been completed: originally because Barclays' priority to the extent any work of this nature was performed was to close the books for LBHI, and more recently because of manpower and professed litigation concerns. The Trustee's efforts to investigate the Barclays repo were impeded because his professionals had no direct access to the MTS and ADP systems to reconcile with DTCC records and no visibility into the transaction. Instead, those professionals had to rely largely on a spreadsheet from Barclays. In fact, the Trustee's professionals had to rely on Barclays employees to make entries into the books and records. Booking what was believed to be part of the Barclays repo on the basis of the collateral in the FRBNY Repo was not completed until late October, more than a month after the liquidation began. Barclays did not complete booking the actual elements of the collateral used for the FRBNY Repo until more than six months later. In the meantime, the Trustee had to operate with inaccurate and incomplete information.

233. In December of 2009 — well over a year after the liquidation began — the Trustee and Barclays agreed on a comprehensive transition services agreement approved by the

Court on March 22, 2010 (the “TSA”).¹⁴¹ Extensive time was involved in these after-the-fact negotiations, and they were conducted at a time when Barclays was already in control of systems and key personnel, placing the Trustee at a disadvantage. Barclays was also in control of third-party vendor relationships necessary to support certain services to the LBI estate, and the Trustee generally had little or restricted visibility into those relationships — despite the fact that Barclays was demanding that the Trustee pay LBI’s share of the charges. In the Trustee’s view the resulting TSA is the best that could be bargained for under the circumstances, and not unfair given the parties’ relative position, but the services are still expensive and inevitably leave the Trustee dependent to some degree on a party with its own priorities and with which the Trustee is in an adversarial relationship. Progress on the TSA was slow and painstaking, and at one point the Trustee drafted and considered filing a motion to have the terms of access to records and information established by Court order.¹⁴²

234. The acquirer’s *de facto* control and the lack of clear rules and agreements led to many delays and mistaken assumptions in the hectic early days of the liquidation when reliable information was needed but often could not be obtained. Not only can delay, inefficiency and mistakes result from such a situation, but opportunities are presented for

141. Order Pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code Approving a Transition Services Agreement between Trustee and Barclays Capital Inc. (LBI Docket No. 2883).

142. An additional problem associated with Barclays’ control of the records was the incorrect generation and mailing by Barclays of “LBI” account statements after the Filing Date. These erroneously created account statements on LBI’s signature green letterhead purported to reflect activity through September 30, 2008 — an obvious impossibility. In addition to purporting to state account holdings at LBI after the Filing Date, some account statements referenced Barclays Capital Inc. as the new manager of the accounts, giving the erroneous impression to those accounts that Barclays had left behind that they were part of the account transfer to Barclays. Account statements were also mailed for certain accounts used solely by Lehman operational personnel to track securities transfers, purchases, and sales. In most, if not all, instances, account holders had not been aware of these operational accounts until they received the statements. In addition to providing inaccurate and confusing information to account holders, these statements added to uncertainty regarding the location of these accounts holders’ assets between LBIE and LBI, issues that continue to be raised to this day and are the subject of approximately 70 claims objections.

strategic behavior, some of which have been discussed during the Barclays trial. Even today with more experience on both sides and clearer ground rules, the Trustee is sometimes distressed by a lack of performance on items such as constructing pre- and post- filing date balance sheets, and the estate continues to pay for many services one might have expected would have been provided voluntarily, in a spirit of cooperation.

235. The point is not that the transfer of the PIM accounts did not produce a substantial benefit or was not a highly desirable transaction. The Trustee has never disputed that it did, and was. But such a transaction may also entail some offsetting and not clearly foreseen detriments to some customers and to the Trustee's efficient conduct of the liquidation. The transaction may have benefited thousands of account holders and saved many jobs, at least for a period of time. Its implementation did not, however, benefit all customers, and many jobs eventually were lost. Account transfers undoubtedly avoided delay and transaction costs to a significant degree, but the resulting relationship between the Trustee and the transferee broker also produced other delays and transaction costs. These tradeoffs should be identified and carefully considered in advance of any major future liquidation.

236. If an acquirer is to pick and choose among accounts, there may be limits to the assets that the acquirer may be permitted to obtain, particularly if assets may be needed for satisfaction of remaining customer claims. Certain liabilities may have to be assumed. Assurances may have to be given that assets will be returned if assumptions prove incorrect and the assets are needed to satisfy claims of remaining customers. An acquirer might also be obligated to assign certain employees to the Trustee or SIPC and make certain critical services and systems available at no or nominal cost for some period of time.

237. At a minimum, the costs and benefits of a partial transfer need to be understood and weighed. If proceeding on such a basis is justified, arrangements need to be clarified in advance — before the acquirer is driving the bus, not after the doors have closed. Amending SIPA to require judicial findings relevant to these issues would be one way of guaranteeing that they are appropriately focused on and dealt with in the negotiations.

IX. RECOMMENDATIONS FOR FUTURE LIQUIDATIONS WITH CUSTOMER IMPLICATIONS, WHETHER UNDER SIPA OR ANOTHER ORDERLY LIQUIDATION AUTHORITY¹⁴³

A. The Need For Planning And Early Involvement Of Representatives Of Customers' Interests

238. These observations underscore the need for a careful advance planning process in any liquidation in which customer assets and interests are at stake. SIPC, regulatory authorities and other elements of the market such as clearinghouses and clearing banks need to be directly involved in that process.¹⁴⁴ The Trustee recommends that knowledgeable operational people need to be accessible to those likely to be charged with liquidating the broker-dealer to explain and share information about the brokerage firm's full range of customer accounts and location of customer and related assets. This includes customer assets financed by the broker-dealer through repos or other transactions that need to be unwound to assure the availability of property for return to the customers or the transferee. The practicalities of how operations will be conducted need to be understood and agreed upon in advance, particularly if the broker-dealer is a subsidiary or affiliate of another entity. (In LBI's case, the complexities were multiplied by the vast number of Lehman entities and their interconnectivity.)

143. See Dodd-Frank Act, §§ 201-217.

144. The recent financial reform legislation does provide for an increased role for SIPC with respect to account transfers. See Dodd-Frank Act § 210(a)(1)(O).

239. Since the trustee or other liquidator of the broker-dealer, not its holding company, will be conducting the liquidation of assets or analysis and satisfaction of customer claims, the holding company should not be the sole negotiator for the broker-dealer. Rather, the potential trustee or liquidator should be given a seat at the table early in the negotiation process. And for that seat to be meaningful, these parties need direct access to key people and information sources.

B. A Required Liquidation Plan

240. The Trustee recognizes, as the Chapter XI debtors and their counsel have, that the LBHI Chapter XI filing was rushed and preceded by scant opportunity for planning.¹⁴⁵ This is in itself a situation that should not be repeated. But in the case of Lehman, what planning there was largely centered on maximizing protection for the Chapter XI entities and not on the details as to how the separate SIPA proceeding would be conducted. Lehman prepared a “contingency liquidation plan” document late on September 13, but the plan focused only partly on LBI, comprised only a handful of slides and warned, “An Emergency Liquidation Plan Can Only Take Place in an Orderly Liquidation” and “There will be no Orderly Liquidation in the Event of a Lehman Default”.¹⁴⁶ This document identified a few potential problem areas at a high level of generality, but set forth no concrete plan for dealing with them operationally. Much more advance planning and attention to detail are clearly required. Before it happened, the failure of Lehman and liquidation of its broker-dealer were almost unthinkable; once disaster

145. *See Too Big to Fail: The Role for Bankruptcy & Antitrust Law in Financial Regulation Reform: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 111th Cong. 9-12 (2009) (statement of Harvey R. Miller, Senior Partner, Weil, Gotshal & Manges LLP); *see also* Jeffrey McCracken, *Lehman’s Chaotic Bankruptcy Filing Destroyed Billions in Value*, WALL ST. J., Dec. 29, 2008, at A10.

146. Lehman Brothers, Default Scenario: Liquidation Framework (Sept. 2008) [LBI_PIR_000191] (attached to e-mail dated Sept. 13, 2008 [LBI_PIR_000018]).

struck, it was too late for planning. While it is to be hoped that there will be no next time, such a failure is no longer unthinkable. It should be planned for, like any other potential disaster.

241. One possible step forward would be a regulatory requirement that each broker-dealer and, where owned by a holding company, its parent, have in place an up-to-date liquidation plan that could be monitored by regulatory authorities. The plan would indicate the categories of customer accounts and associated assets that would need to be protected and set forth how possible scenarios would be dealt with, ranging from complete liquidation of all customer accounts to total or partial account transfer solutions, with details of key operational steps and the core assets that would have to remain to assure effective liquidation of customer accounts. Whatever conditions a potential partial acquirer would have to be prepared to agree to could be spelled out in such a plan.¹⁴⁷

242. The Trustee was handicapped in his administration of the liquidation by the absence of any such plan and the related inability to locate basic documents and information. This lack of basic information would also make it difficult for potential acquirers of customer accounts to perform due diligence or understand the nature of the accounts potentially subject to transfer. Even something as simple as a mapping of customer accounts explaining and identifying the account ranges and agreements associated with them, the applicable systems and box locations, and the collateral associated with them was lacking. As noted, the Trustee did not know, and was given contradictory and erroneous answers about, the number of or types of customer accounts that would remain in the SIPA proceeding. Not all prime brokerage account agreements could be readily located, nor did documentation exist describing the relationship of

147. See Trustee Recommendation: A Required Liquidation Plan (attached hereto as **Exhibit D**).

prime brokerage account customers to the other Lehman entities. Mutual fund relationships were not listed in any single document or location. Up to date, comprehensive files in a single place did not appear to exist for things like no lien letters and subordination agreements.

243. The type of plan we envision would be designed to prevent a recurrence of this lack of transparency and would require information and documents and comprehensive mapping of customer accounts to be maintained and updated by regulation or statute. It would include schedules of key systems and information sources and human resources and how they would be made available to a SIPA trustee or other liquidator. A SIPC member would be required to maintain an index of key contractual and other documents including lists of clearing banks and bank deposits, major repo and stock loan/stock borrow counterparties, computer systems, system and information provider vendors with continuing relationships, and contracts with each affiliate. Broker-dealers would also be required to maintain in a readily accessible location subordination agreements, clearing agreements, no lien letters, account contract forms, and actual agreements for major customers and for classes such as prime brokerage customers.

244. Key systems and vendors and summaries of the contractual commitments, termination provisions and costs should be assembled and updated regularly, and attention should be given to assuring continued provisions by vendors of critical services. This assurance of continued access on some reasonable terms is particularly critical for key services that were shared with affiliates prior to the filing date. Record-keeping systems should be reviewed for currency and accuracy. There should be mapping of accounts with common identifiers for locating collateral. The Trustee and his professionals, when researching counterparty transactions, encountered difficulties in identifying or reconciling transactions because names of counterparties were not uniform and transactions themselves were misdescribed (*i.e.*, trades that

are not repos booked as repos). Template provisions for transition service and account transfer agreements or protocols could ideally be prepared in advance. In addition, notices should be prepared to send to appropriate organizations, such as the Securities Industry and Financial Markets Association (“SIFMA”) and FINRA, to publicize the need for customers of the broker-dealer to change their wire instructions with respect to funds transfers to accounts maintained at the broker-dealer, to avoid having these funds frozen in the liquidation proceeding.

245. The plan should also consider relationships, transactions and access to records with remaining affiliates, particularly foreign affiliates, and the timing of the initiation of insolvency proceedings in relation to the SIPA or other liquidation proceeding. In the case of LBI, a decision had been made by LBHI to transfer LBI’s subsidiaries to LBHI in exchange for a note for their value as of the times of their transfer. Other aspects of the relationships among the companies were not discussed in any detail; LBI was not party to any TSA involving affiliates until recently when the Trustee entered a TSA with LBHI. The effect of LBHI’s Chapter XI filing several days before the SIPA filing was not fully understood, especially its effect in accelerating the entry of LBIE into administration; yet LBIE’s status froze customer and other transactions between LBI and LBIE and has greatly complicated the liquidations of both entities.

C. Planning Beyond The Broker-Dealer: Third Party Holders Of Margin, Deposits And Collateral

246. The plan should also address in a specific way relationships with depositories, clearing banks and holders of collateral. Ideally, representatives of those institutions should be consulted in connection with the plan. The manner in which accounts would be handled by DTCC or other clearing organizations holding significant property would need to be addressed, preferably with participation by the clearing organizations themselves. Possible obstacles to prompt recovery of customer property from “good control” locations in

foreign jurisdictions should also be identified. Although obstacles attributable to differing laws or insolvency regimes present formidable challenges, attention should be given to the terms of customer custody and counterparty agreements that at least minimize these obstacles to the extent possible. The manner in which the often untested emergency rules of exchanges and depositories might work in practice should be closely analyzed against the reality of a brokerage failure, and bankruptcy counsel with SIPA and other relevant experience as well as regulators should be consulted.

247. In LBI's case the CME conducted an emergency, secret auction without any participation by LBI, SIPC or the Trustee. This was an unprecedented transaction and the first such auction the CME had ever conducted. The CME credited or debited to LBI any profits or losses from LBI's portfolio based on the prior day's settlement closes. The result was that acquirers stepped into LBI's shoes on September 18 (the date of the transfers), with significant losses to LBI in the form of margin posted at the CME associated with the transferred positions. At the Barclays sale hearing on September 19 it was announced that this action had depleted all the cash left at LBI.¹⁴⁸

248. Similarly, on the evening following the liquidation filing and during a recess at the hearing itself, the OCC threatened not to transfer any accounts unless Barclays stepped into LBI's shoes at the OCC. Barclays agreed when it realized that this arrangement was likely to produce a substantial windfall for itself. Regulatory authorities and regulated exchanges contend that these actions are necessary to assure against losses and that they and participants are immune from liability. The more fundamental question is whether this is appropriate policy and

¹⁴⁸. See *supra* Section V.A.1.

whether all or at least some portion of margin that proves to be unnecessary to fulfill obligations should be remitted to a Trustee. The OCC's transfer agreement required margin associated with customers to be transferred to Barclays whether or not the customer was transferred to Barclays, with the result that positions in some of the accounts left behind by Barclays might be unprotected. Additionally, LBI had properly included a debit in its SEC Rule 15c3-3 customer reserve calculation for approximately \$500 million of the margin deposited at the OCC. The debit reduced LBI's reserve requirement by approximately the same amount. The treatment of the transfer of all or any portion of this component of the margin other than for the account of customers — the subject of a dispute with Barclays — would have placed LBI in violation of Rule 15c3-3 and left a hole in LBI's customer reserve account.

249. Sales or transfers are attractive to exchanges because they eliminate risk of loss to the exchange and its members as well as other participants. While the question of exactly what Barclays and others should have obtained and other aspects of these transactions are being or may in the future be litigated, it is not clear that a transfer of all positions and all related property and deposits is an optimal solution from the standpoint of overall public interest. The broader policy question is how protection for clearing organizations and their members must be balanced against the interest of a failed broker's customers and creditors in any residual assets or deposits. The emergency solutions of the CME and the OCC protected the exchanges' customers and members but seem to the Trustee to have unnecessarily deprived the LBI estate of hundreds of millions of dollars of residual margin and to have unnecessarily jeopardized the interests of at least some customers. The Trustee recommends an industry-wide study of these

issues, with participation by both foreign and domestic securities and commodities regulators.¹⁴⁹

What will happen to a broker's positions — and particularly what will happen to margin or deposits that prove to be excess or that are debited/credited in the broker-dealer's Rule 15c3-3 customer reserve calculation — is an issue that should be addressed by the broker, the exchanges and regulators in a comprehensive planning exercise.

250. DTCC in particular holds huge quantities of property for broker-dealers and their customers. DTCC did not conduct an emergency auction or sell-off but invoked its rules to complete and guarantee trades and then liquidated positions over time. DTCC also cooperated in transferring accounts or other property, although even on that score it took precious weeks for the Trustee to obtain direct access to screens. The Trustee had no access to DTCC screens until October 10, 2008, over three weeks after commencement of the liquidation. The Trustee is obtaining an accounting of DTCC's disposition of collateral but believes that DTCC generally facilitated orderly transfers and liquidations. Most of the over 400 separately instructed securities and cash transfers in the account transfer process were effected through DTCC. Nevertheless, because of the enormous amount of property DTCC controls and the central role it plays in property transfers, the Trustee recommends that its rules for insolvent broker-dealers and operations be studied against the Lehman experience. The rules are complex and not thoroughly understood by the brokerage community. Its system also proved less than equal to the task of transferring billions of dollars immediately on the evening of September 19.

149. Other LBI custodians or depositories around the world exhibited varying ranges of acceptances of the Trustee's powers. In Israel, a depository would not recognize the authority of the Court, and that situation has resulted in litigation. (*See* LBI Docket No. 2288.) In other parts of the world, the transfers were often delayed by uncertainty or an unwillingness to cooperate.

Finally, access to key screens for determining location or movement of customer and proprietary assets should be effective and immediate.

251. The fact that Barclays did not fully assume the trading obligations of LBI also influenced DTCC's actions in the immediate aftermath of the SIPA filing, and caused unnecessary risk and disruption in the transfer of customer securities. The uncertainties that existed on September 19 about the nature of the Barclays transaction, and the realization that Barclays would not stand behind all LBI obligations to deliver cash or securities, engendered concern on the part of DTCC that the deposit it was holding to secure due performance by LBI of its trading obligations would not be sufficient. In addition, uncertainty regarding whether LBI's settlement bank would fund LBI's settlement obligations caused DTCC to reverse certain ACATS transfers (transfers pursuant to pre-petition customer instructions to send their property to financially sound brokers) resulting in seizure of customer securities. Although these securities were appropriately designated as customer securities when the ACATS transfer process began and should therefore have been immune from seizure, DTCC took the position that, following the ACATS reversals, its automated systems lost the ability to distinguish customer from non-customer property.¹⁵⁰ Following the DTCC seizure, it fell to the Trustee to obtain release of the detained customer property through the "ACATS Settlement," which was approved by the Court on February 11, 2009. The fact that in ACATS transfers, previously segregated customer property is not protected appears to the Trustee to be an aspect of the system that in itself requires further study.

150. It should be noted that it is not the ACATS reversal process that causes a "customer security" to lose that identity. In order to transfer "customer securities" that were segregated at DTC (whether by a deliver order through DTC, a CNS delivery or an ACATS delivery through NSCC), the broker must have the security in its "free account." When assets move to the "free account," they are fungible with all other assets therein, and thus potentially exposed to inappropriate seizure.

252. DTCC is a membership organization whose constituents are themselves securities broker dealers. These entities reap the benefits of the federal scheme of customer protection, which includes SIPA and the complementary SEC Financial Responsibility Rules, and which were designed to restore and maintain investor confidence by assuring the safety of property entrusted to SEC-regulated broker dealers. As DTCC and its members are aware, a primary goal of the federal scheme is to insulate customer property from seizure by creditors, with the promise to investors that it will never to be used to pay debts of failing broker dealers. The circumstances of Lehman's collapse were so unprecedented that DTCC itself may not have understood the effect of trying to reverse the ACATS transfers automatically. In examining its rules, the effect of its automated systems must be analyzed and a balance has to be struck between efficiency of operations and protection of DTCC's membership on the one hand and assuring protection of customer property and integrity of the Financial Responsibility Rules on the other.

253. On June 4, 2010, DTC and NSCC, the DTCC subsidiaries involved in the ACATS reversals on September 19 and 22, 2008, filed proposed rule changes apparently designed to reduce the risk that customer CNS-eligible securities in transit between brokers using the ACATS system would be subjected to seizure to satisfy the debts of a defaulting broker.¹⁵¹ These changes and related explanatory material in DTC's Settlement Services Guide would "clarify that securities moving through NSCC's ACATS system are not subject to a lien by DTC

151. See Self-Regulatory Organizations the Depository Trust Company, Exchange Act Release No. 34-62384, 75 Fed. Reg. 47655 (Aug. 6, 2010).

when they are debited from a delivering Participant's DTC account or when they are credited to a receiving Participant's DTC account."¹⁵²

254. Questions, however, remain under the proposed rules regarding circumstances under which NSCC (as opposed to DTC) could still impose liens on customer property.¹⁵³ The proposed rule changes also do not appear to take account of non-CNS securities, which are entitled under SEC rules to the same protections against assertions of liens by custodians. The Trustee applauds DTCC for proposing changes to the rules in light of the Lehman experience but believes there should be no circumstance, however theoretical or improbable, in which customer securities are at risk of lien imposition and seizure by any DTCC subsidiary, whether in connection with the CNS system or otherwise, and would welcome endorsement of this principle as well as further clarification of the proposed rule.

255. The role of foreign law or procedures on depositories that are considered good control locations for purposes of the SEC customer segregation rules has also proved problematical in the LBI liquidation. In some cases where LBI held accounts at foreign depositories classified as "good control locations" for SEC compliance purposes, the actual result has been seizure or freezing of assets.

256. LBIE maintained accounts at foreign clearing houses, exchanges and depots, for example, Euroclear, Swedbank, Israel Discount Bank, BNP Paribas, and Royal Bank of Canada, among others, which were intended to hold customer property, some of which was for LBI's customers. Not all the money and property in these accounts was present at the time

¹⁵²*Id.* at 2.

¹⁵³*See, e.g.*, The Depository Trust Co., Proposed Rule Change (Form 19b-4), at 16 (June 4, 2010) (describing conditions under which customer securities will be "deemed to be released to NSCC by the receiving Participant, in partial satisfaction of its settlement obligations to NSCC").

LBIE was forced into administration. Under English trust rules, property actually segregated must be returned to owners, but it was unclear how these rules might apply to cash that should have been, but was not, segregated against the backdrop of the Financial Services Authority's client money rules. The High Court held that those with funds actually segregated could claim to the extent of those funds against the client money pool. The Court of Appeal recently overruled the High Court in part, deciding that the LBI Trustee and other parties who actively prosecuted the appeal and who had claims for client money that should have been but was not segregated by the date of the administration (i) could share in the client money pool, and (ii) that the pool could be augmented by unsegregated but identifiable funds required to have been segregated. In any event, as soon as LBIE entered into administration as a result of LBHI's Chapter XI filing, LBI customer property became unavailable, at least on any ready basis, with a potential shortfall in property to be returned to customers.¹⁵⁴ Similar problems or delays have arisen in other jurisdictions such as Japan. The SEC might wish to review its rules and require further assurance, (i) that property and cash in depots maintained by affiliates or others that are considered good control locations actually are maintained in segregation in these accounts and (ii) that the property and cash actually are accessible under the laws or procedures of the applicable foreign jurisdiction. As noted earlier, review of the terms of agreements relevant to foreign custody and deposit accounts in light of the LBI experience would also be in order.

D. Possible Requirement For Additional Court Findings

257. One statutory step that would focus attention on planning and provision of information and would complement the above recommendations would be a requirement for

154. See Motion for an Order Approving Trustee's Allocation of Property of the Estate, at ¶¶ 95-6 (LBI Docket No. 1866).

court findings on customer-related matters in connection with transactions such as partial asset sales or account transfers in which the liquidated broker-dealer is asked to participate. The findings in the order approving the sale transaction in the Chapter XI proceeding focused, as required by Chapter XI, on the transaction from the point of view of the Chapter XI debtors and their creditors. Additional findings might be required in SIPA cases as to the approximate number and magnitude of customer accounts and property involved and the extent to which provisions have been made to assure three things: (i) the likelihood of reasonably equal and adequate treatment of all non-affiliate customers, whether their accounts are transferred or left behind; (ii) the SIPA trustee's or other liquidator's effective access to customer property, wherever located, to assure the reasonably fair and adequate treatment of all customers; and (iii) adequate continued access to books, records and personnel, including provisions for cooperation at no or nominal cost. SIPC or any SIPA trustee or other liquidator and the SEC would have to support the adequacy of the showing made by the proponents of a transaction. Circumstances ordinarily would not permit extraordinarily detailed findings to be made, but requiring findings on these matters would force the parties to focus some attention on the interests of the broker-dealer and, most importantly, provide information to, and negotiate certain key parameters with, those primarily concerned with customer protection.

**E. Clearing Bodies, Set Off And Liquidation Rights,
Visibility And Access To Information — Balancing Safe
Harbors With Quid Pro Quos For The Protection of Customers**

258. As long as the securities industry is dependent on private sources such as the clearing banks and DTCC rather than governmental sources such as the Federal Reserve for clearing operations, these entities will need security and should not be prevented from exercising legitimate rights of secured creditors in future liquidations, provided that they act reasonably in

the exercise of those rights. The LBI experience teaches, however, that safeguards are necessary with respect to the manner and visibility in which rights are exercised.

259. Clearing banks held enormous amounts of LBI collateral which they were able to hold or liquidate with little or no visibility or accountability until well into the LBI SIPA proceeding. The Trustee continues to investigate these activities and may assert claims to the extent customer or proprietary property was improperly seized or liquidated. Visibility and accountability should, however, be contemporaneous and complete rather than after the fact and partial.

260. In the early days of the LBI liquidation, the Trustee had no access to data screens at LBI's clearing bank, JPMC, and even when access was obtained in principle it often was impeded in practice by mistakes and bureaucratic obstacles. In the ordinary course of business, these data screens permitted LBI to monitor activity in customers' accounts. JPMC froze screen access before the commencement of the SIPA liquidation, but continued to process transactions in LBI's accounts through and beyond close of business on September 19, 2008. This ultimately resulted in the Trustee and his professionals expending substantial resources to identify the ownership and interest in securities that were part of trades or other transactions that settled during this JPMC-imposed blackout period. The Trustee and his professionals had to reconcile accounts to the last records reflecting positions in LBI's accounts before the blackout period in order to assess claims as of the filing date to account for accruals going forward. Even more significantly, this freezing of access prevented normal processes for accessing account information and giving instructions for segregating customer property from being implemented. The result was that the Trustee had no visibility into whether customer property believed or intended to be segregated was in fact seized.

261. Issues of information access are intrinsic to any system where the entities on which the broker-dealer is reliant to provide information have an inherent conflict of interest, either as purchasers of assets or as creditors of the estate. To remedy the conflicts caused by the foreseeably adverse nature of these relationships once the broker-dealer has entered liquidation, the bilateral information systems on which a broker-dealer relies in conducting business with its clearing bank must have the capability to maintain visibility to information, even if electronic trading access to accounts is cut off or activity in the accounts is frozen. Requiring systems to maintain visibility will also ensure that any actions taken by clearing banks in their capacity as creditors of the broker-dealer's estate are done with complete transparency and accountability.

262. Ultimately, it took several weeks for the Trustee to finalize a confidentiality agreement with JPMC; even with an agreement in place, access was limited to certain identified people (only after they signed individual confidentiality agreements with JPMC) and sometimes denied because of bureaucratic misunderstandings or confusion. It was a great surprise for the Trustee's professionals to learn for the first time after the fact, in the midst of account transfers and assessment of assets available to satisfy customer claims, that hundreds of millions of dollars of fixed income securities held for prime broker accounts and believed to be in segregation had in fact been seized by JPMC. The contractual relationships and course of dealing relevant to JPMC's actions is being investigated by the Trustee and discussed with JPMC. But, whatever the merits, this is not something a SIPA trustee and his professionals should learn about after the fact because of lack of access to information. Account transfers and realization of assets were impeded, and the expenses of administration greatly increased, because of this simple lack of immediate access to real-time information.

263. The Trustee recommends that future SIPA trustees or other liquidators be provided with continuous, unimpeded access to systems that monitor broker-dealer activity, and that transmission of information by clearing banks be continued without interruption on the same basis as prior to the SIPA proceeding. This information flow should include daily reports identifying (a) CUSIP-level detail of securities transactions that will occur post-filing, including trade settlements and unwinds of repurchase transactions, covering both the debtor's outgoing obligations and anticipated receivables and (b) securities that the clearing banks have liquidated.

264. Further, clearing banks should be required to respect the Financial Responsibility Rules and the broker dealer's duty to comply with SEC Rule 15c3-3 and strictly respect the segregation of all customer property that was or should have been at any time even arguably segregated for customers in compliance with Rule 15c3-3. In cases of doubt, banks should not assert or implement setoff or foreclosure rights against property in such accounts until such time as the Trustee and SIPC or others charged with the liquidation agree, with notice to regulatory authorities.

265. The Trustee makes the following additional recommendations with respect to clearing organization relationships:

- To the extent that the clearing banks are aware that any securities in their possession may be treated as customer property, they should be required to notify the trustee and SIPC or other liquidator of the particulars, and to segregate and hold in custody those securities, thereby providing the Trustee the opportunity to recover such customer property.
- To the extent that the liquidator becomes aware and notifies a clearing organization that any particular collateral in its possession may be customer property, the clearing entity should be required to segregate and hold in custody those securities and cooperate in providing information to the trustee that will permit the trustee to determine whether the securities at issue are customer property and how they came to be seized by the clearing bank.
- To the extent the liquidator becomes aware and notifies a clearing bank that any particular collateral in its possession is necessary to satisfy customer claims, the clearing

banks should be required to negotiate in good faith with the trustee for substitution of such collateral.

- Banks should not be able to prevent access to systems for allowing the broker-dealer to receive property or to impede the normal processes for designating customer property as segregated or to be deposited into safekeeping accounts.
- Paragraph VII of the order commencing the SIPA liquidation stayed foreclosure against LBI property held as collateral by counterparties to repos and securities lending agreements for twenty-one days but provided an opportunity for relief from the stay if SIPC and the Trustee consented to a third party request. This consent was usually granted but allowed some transparency (as well as providing a source of funding in the early days of the liquidation). Paragraph VIII (F) of the order excluded clearing banks from the stay. Consideration ought to be given to including them in the temporary stay, at least for a limited period of time, in order to increase transparency, subject to allowing a lift of the stay by consent of SIPC, the trustee, or other liquidator, if relief is requested by a clearing bank in order to advance a clearing bank's reasonable efforts at self-protection.

F. Must There Be A Single Fund Of Customer Property?

266. Under SIPA the only customer property actually deemed to be property of a particular customer are customer name securities — physical securities held by the broker-dealer and registered (or in the process of being registered) in the customer's name.

SIPA § 78lll(3). All other securities positions, even when held in identifiable accounts or in certain identified account ranges, are considered part of a fund of customer property in which a customer has a claim to a pro rata share based on the customer's net equity in proportion to the total of all net equity claims.¹⁵⁵

267. Originally, SIPA had provided for "specifically identifiable" customer property. *See* SIPA § 78fff(a)(1)(A) (1970). This definition included securities in book entry

155. *See* Order Approving Trustee's Motion for Allocation of Property of the Estate, In re Lehman Brothers Inc. (LBI Docket No. 2743) ("[P]ursuant to 15 U.S.C. § 78lll(4)(D), the amount of any property of LBI which the Trustee determines would, upon compliance with applicable laws, rules, and regulations, have been set aside or held for the benefit of customers to prevent shortfalls in Customer Property, including without limitation those shortfalls identified in the Trustee's motion papers, shall constitute and be allocated as part of "Customer Property."").

form registered in the customer's name and other property that could be identified as held for a particular customer, including some property segregated in bulk for customers. As with the narrower class of customer name securities under the current statute, *see* SIPA § 78lll(3), this property could be returned to the customer in kind, if available, without becoming part of the pooled fund of customer property.

268. The concept that some but not all securities would be “‘specifically identifiable’ did not adequately reflect the segregation practices that had evolved to meet changes in the marketplace.”¹⁵⁶ This concept was abandoned when Congress amended SIPA in 1978 because the definition was hard to apply and led to anomalous, unfair results, as it could be a matter of chance which customers' securities were properly segregated and which were not on the filing date. Under the 1978 SIPA amendments, Congress eliminated the concept of “‘specifically identifiable’” property in favor of the much narrower concept of “customer name securities,” which consist of “securities held by the debtor for the account of a customer on the filing date, and which are registered in the name of the customer or are in the process of being so registered at the debtor's instructions.”¹⁵⁷ “Excluded from the definition are securities in the name of the customer, but that have been made negotiable by endorsement or otherwise.”¹⁵⁸ As such, a customer may now only reclaim securities “if there is a nonnegotiable certificate in [his

156. Michael E. Don & Josephine Wang, *Stockbroker Liquidations Under the Securities Investor Protection Act and Their Impact on Securities Transfers*, 12 CARDOZO L. REV. 509, 529 (1990) (describing progression from “tagging the securities or placing them in envelopes marked with the customers' names,” to “bulk segregation process” that earmarked securities for groups of customers, to the “one box” bookkeeping system).

157. *Id.* at 540-41; SIPA § 78lll(3).

158. Don & Wang, *supra* note 156, at 541.

or her] name in the debtor's possession or control."¹⁵⁹ Nevertheless, many customers mistakenly conceive of positions appearing on their account statements as being held in a segregated or designated account for them, much as if there still were a category of specifically identifiable customer property, *i.e.*, property held in a quasi-trust relationship for specific customers.

269. The Trustee does not believe that it is possible to return to the concept of specifically identifiable property on a widespread basis. Industry conditions require too much commingling of property and use in financing to ensure consistent treatment of customers. On the other hand, the concept of a homogeneous base of customers with claims against a homogeneous fund of customer property is one that does not fully comport with many customers' expectations and does not recognize differences between different account relationships.

270. In LBI's case, the PBAs formed a relatively discrete — but complicated — set of accounts. The agreements those PBA holders with equity securities signed were different from those signed by PIM, PAM and other customers and provided for greater rights of LBI to hypothecate securities or purport to make property in these accounts available for assertion of liens by other Lehman entities. At the same time, these accounts may have been touted to customers as being maintained as separately identified accounts or account ranges with customer names in DTCC or Chase boxes. Some aspects of the relationship such as the freedom provided to the broker-dealer to use securities in the account for its own purposes and to look to them for satisfaction of indebtedness on an enterprise-wide basis seem to point in the direction of less customer protection than that to which the traditional customer is entitled; other aspects such

¹⁵⁹*Id.* at 541-42.

as account range designations might point in the direction of greater protection. Industry sources and press reports indicate that as a result of the LBI experience, hedge funds and other participants are seeking additional protections such as special custodial accounts or limitations on the broker-dealer's freedom to use their property.

271. Consideration should be given to amending SIPA so that accounts with such shared characteristics could be regarded as having the corresponding assets separately held in a sub-fund or pool of prime brokerage property. Distributions to these accounts could then be made in the first instance from that pool, potentially making it easier to determine claims and transfer property. Initial distributions from this pool would not be delayed because of unavailable property or disputes about customer treatment or account contents in other parts of the customer population such as affiliate accounts or depositories used as clearing accounts. The SEC segregation rules for accounts with certain characteristics could be tailored to those accounts and the agreements covering them. (Of course this presupposes that parties on both sides will read and understand the agreements they sign, something that does not seem invariably to have been the case with many customers at LBI, including many PBAs.)

272. The concept of separate estates or sub-pools of customer property is embodied in the rules of the CFTC dealing with commodities brokerage. These rules actually create five separate estates or pools of property corresponding to the capacity in which a public commodities customer transacted business with the broker (*e.g.*, leverage transaction or commodity options trader), 17 C.F.R. § 190.01(a). Under these rules, non-public customers, whose property is not required to be separated and who include affiliates and insiders, are treated separately and are essentially subordinated to public customers.

273. Under this approach not only pure brokerage accounts but other subsets of accounts could be treated as separate pools. For example, property attributable to a clearing arrangement such as the LBIE customer undisclosed clearing agreement might be maintained separately from both LBIE proprietary and other customer property and distributed in the first instance as a separate fund available for ultimate distribution to underlying clients of the introducing broker. This approach could allow much more prompt (even if not necessarily complete) distribution of property than under the present statute; under SIPA as it exists today the LBIE claim (based on a September 12 or September 15 date because of its earlier administration) must be reconciled with LBI's records (as of its filing date of September 19) for a net equity claim; this claim can only be satisfied when the sum of *all* net equity claims against all customer property from *all* LBI customers can be determined. At one time LBI maintained a separate box at DTCC for the LBIE omnibus account, although eventually this separate box was closed in favor of one account at DTCC. Maintaining such property in a separate box and treating it by statute as a separate fund for distribution in a SIPA liquidation could reduce much confusion and aid in the administration of these accounts.

274. Other rules might apply to accounts maintained by affiliates or subsidiaries of the debtor such as the LBIE proprietary account or the hundreds of accounts submitted as customer claims by the Chapter XI Debtors. To the extent such accounts may qualify for customer treatment at all, it is not apparent why they should necessarily share on a ratable basis with accounts of unaffiliated third party customers when the effect may only be to create or exacerbate a shortfall in available customer property for the customer population as a whole. (Most of the Chapter XI Debtors' accounts were subordinated, but that was not true of all accounts or of LBIE's house account.) This is especially true of affiliate accounts where

segregation of property was not required by SEC regulation. No determination has yet been made with respect to treatment of these accounts, but the statute or SIPC rules might reduce confusion in future liquidations by specifying that these accounts may be treated as a separate class with rights to claim on a party with other customers only for what is set aside for the affiliates' underlying customers. Otherwise general creditors of affiliates may effectively share in distributions of customers' property in contravention of the most basic purposes of the SIPA statute.

275. Finally, the current concept of the fund of customer property along with corresponding customer segregation and protection rules might be largely retained but in slightly modified form for the paradigmatic public customer accounts — those which form the great bulk of the broker-dealers' core brokerage business. (In LBI's case, these accounts comprised over \$90 billion of property or at least 85% of all non-proprietary property, although most were transferred either to Neuberger Berman or Barclays.) This fund would not be diluted by claims of other classes of customers. In order to achieve clarity and conform more closely to public expectations, an expanded notion of customer-specific property might be incorporated, albeit not as broadly as the former regime of specifically-identifiable property. Rather, in addition to customer name securities, some other account relationships might give rise to a right of immediate return for property held in a safeguarded, primarily custodial fashion (for which restrictions on use the broker-dealer might well charge custodial fees).

276. A benefit of differentiating among different categories of accounts in determining rights to distributions could be the account holder's acknowledgement of the broker's custody arrangement for the securities held for it. Account holders seeking the traditional entrustment service of a brokerage would aptly fall within one custody pool, with

their assets segregated as customer assets. Other investors seeking greater leverage or margin would more directly acknowledge the risk being taken on alternative custody arrangements. Traditional entrustment type clients would not then find themselves backstopping accounts with fundamentally riskier or different investment strategies. Likewise, should an account holder choose to pay for the benefit of a separately designated custody location, customer property designation rules would have to allow for a SIPA trustee or other liquidator to honor the broker's promise to return that property expeditiously.

277. The Trustee recognizes that no solution is likely to be foolproof and that study would be needed to calibrate the rules for allocating and segregating property with the purposes of each kind of account, as well as the logistics of operating a major broker-dealer and processing and financing hundreds of thousands of transactions a week. On the other hand, the concept of sharing in a vast fund of customer property is not one that many customers comprehend. Even sophisticated hedge funds made hundreds if not thousands of phone calls and sent at least as many emails, and some sought to initiate discovery under Rule 2004, in the early days of this liquidation seeking to confirm the location, if not also immediate return, of "their" securities by reference to CUSIP numbers even though securities with the same CUSIP numbers might be held in great quantity for many different claimants. Some of these questions and demands continue to this day despite the Trustee's and SIPC's efforts at education to the contrary through court filings, interim reports, website postings, appearances at public or industry programs and telephone calls and meetings.

278. The agreements governing the relationship and nature of account activity vary greatly as between, for example, a hedge fund with an active prime brokerage account, a person or company with an individual margin trading account, a former subsidiary of LBI, and a

fiduciary or company with treasury stock holding property at LBI in a largely or entirely custodial fashion. Consideration ought to be given to creating rights to return of property that correspond more closely to the terms of specific types of agreements and the nature of the account.

279. Treating similarly situated customers in as equal and non-discriminatory a fashion as possible is a desirable goal, but the concept of a unitary fund to be administered for customers no longer corresponds closely to the diverse array of customer relationships maintained by a major modern broker-dealer. The single fund concept may actually result in unfairness and delay to some classes of customers.

G. Reasonable Enhancement Of The SIPC Fund And Borrowing Or Guarantee Authority

280. While recent legislative efforts have increased the size of the SIPC Fund and enlarged SIPC's borrowing authority, the Trustee recommends that consideration be given to increasing the SIPC Fund even further and expanding the borrowing and guarantee authority available to SIPC trustees or other liquidators and to permitting more flexibility for use of those funds.¹⁶⁰ While the previously-existing SIPC fund had more than sufficed to meet the demands of all previous SIPA liquidations, the LBI liquidation shows that the failure of a single major SIPC member broker-dealer could require at least the temporary availability of much more substantial sums.

281. Additional enhancement of the availability of funds through a combination of a larger SIPC fund and increased borrowing authority would not involve a significant effect

160. See Dodd-Frank Act, §§ 929C (amending SIPA § 78ddd(h) to permit SIPC to borrow up to \$2.5 billion); 929(V) (amending SIPA § 78ddd(d)(1)(C) to increase the minimum assessment on SIPC members to "0.02 percent of the gross revenues from the securities business" of the SIPC member).

on the Treasury. Financing by the government would be minimal, as most funding would be provided by the industry, and any temporary call on government funds would be relatively modest in size and in the nature of a last resort. This increased SIPC Fund will, however, better reflect the size of the marketplace that exists today and the resulting potential customer obligations and should give SIPC, SIPA trustees or other liquidators increased flexibility in structuring and processing orderly liquidations. The larger fund may also permit guarantee or indemnification authority beyond that in the current statute which could help ensure rapid transfer or access to customer property.

282. In addition, an enhanced indemnity or guaranty authority might have helped ameliorate some of the issues discussed in the Report. For example, a SIPC indemnity guarantee might help support a Trustee's or other liquidator's ability to obtain a medallion or some authority akin to it to prevent transfers from being refused or delayed. It would also increase a liquidator's ability to provide some measure of indemnification for account transfers in order to obtain disputed collateral from clearing banks or others, and therefore enhance the ability either to arrange transfers outside of liquidation or to move a liquidation forward more expeditiously. Some guarantee authority even for non-securities transactions might reduce demands for emergency liquidation or transfer of all margin for options or commodities positions such as those made by the CME and OCC.

283. Insofar as the indemnity is concerned, SIPA currently gives a Trustee authority to indemnify a SIPC member against losses in the transfer of customer accounts and permits SIPC to advance funds for that purpose. SIPA § 78fff-3(b)(2). The Trustee recommends that consideration be given to expanding this indemnification authority for other defined purposes.

284. Each of these possibilities would assist an orderly liquidation and transfer of customer accounts, and each would require only a modest expansion of the financial resources available to SIPC. Additional statutory amendment may be necessary to define additional purposes for which SIPC funds might be used as guaranties or indemnities, accompanied by conforming amendments to the SIPC Charter and Bylaws.

H. Tailoring Safe Harbors To SIPA: Short Term Stays And Consensual Relief

285. As Professor Thomas H. Jackson of the University of Rochester, among others, has noted, legislators considering financial reform have paid little attention to the extent to which the safe harbor provisions of the Bankruptcy Code were “a major excuse for the now-discredited bailouts of the 2008 financial crisis.”¹⁶¹ Of course, Lehman did not benefit from any such bailout, but the actions of the Lehman entities’ lenders and counterparties provide an apt example of the possibly deleterious impact of self-interested behavior in a liquidation scenario. The commencement of LBHI’s insolvency proceedings on September 15 gave the lenders and

161. Thomas Jackson & David Skeel, *Bankruptcy Reform Will Limit Bailouts*, WALL ST. J., Apr. 21, 2010, at A21; see also Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. CORP. LAW 469, 472, 493 (2010) (“Although it was hard to distill a consistent policy rule from the government’s rescue efforts, one guiding principle was its preference to avoid all possible bankruptcy filings because of the supposedly severe consequences that would follow” due to “[c]ounterparties’ ability to jettison their contracts when a debtor files for bankruptcy [] creat[ing] a run on the debtor’s assets, as numerous counterparties terminate their contracts and seize any collateral securing the contracts.”); Stephen J. Lubben, *Repeal the Safe Harbors*, 18 ABI L. REV. 319, 329-30 (2010) (“The safe harbors did nothing to protect the derivative markets from AIG’s collapse – the U.S. Treasury’s largess prevented the systemic collapse . . . Indeed, some of the safe harbors plainly worsen system risk. For example, with no threat of having the transaction reversed as a preference, derivative counterparties have every incentive to setoff contracts and seize collateral upon the first hint of financial distress. In short, this particular safe harbor provision encourages a run on the bank.”); David A. Skeel Jr., *Bankruptcy Boundary Games*, 4 BROOK. J. CORP. FIN. & COM. L. 1, 6 (Fall 2009) (“The decision to bail out Bear Stearns, rather than to allow it to file for bankruptcy, stemmed at least in part from the perceived consequences of default and termination for the repo and derivatives markets,” and, with respect to AIG, “regulators clearly did not trust counterparties’ exemption from the bankruptcy stay to neutralize potential systemic effects.”); Ji Hun Kim, *The Need to Amend the Bankruptcy Code’s Treatment of Derivatives*, 18 J. BANKR. L. & PRAC. 6 Art. 3, 6 (Nov. 2009) (“Under the Code, counterparties have the right to close out contracts when a debtor files for bankruptcy. This, in turn, can create panic or a run on the debtor’s assets. This is likely to occur when numerous counterparties terminate their contracts and seize any collateral securing the contracts.”)

counterparties not only of LBI but also other Lehman entities the opportunity to terminate financial contracts, demand additional collateral or liquidate what they already had in hand in an extraordinarily distressed market. The actions of SIPC and the Trustee in the case of LBI suggest, however, an alternative that would mitigate that impact in future broker-dealer liquidations.

286. Ordinarily, on the commencement of an insolvency proceeding, the automatic stay provisions of 11 U.S.C. § 362 preclude contracting parties from taking actions adverse to the debtor. Counterparties to derivative and other defined financial instruments, however, enjoy statutory exemptions from the stay, among other bankruptcy provisions. 11 U.S.C. § 362(b)(6); SIPA § 78eee(b)(2)(C). The LBI Liquidation Order also provided that clearing banks and clearing organizations and actions taken pursuant to swap and other agreements were exempt from the stay.¹⁶² As a result, these counterparty-creditors were free to terminate their contracts with the Lehman entities, demand more collateral, or in some cases liquidate the collateral that they held.

287. At the same time, the stay provisions of the Bankruptcy Code and SIPA prohibit the broker-dealer's repo and securities lending counterparties from enforcing liens, pledges and setoff rights following the commencement date. 11 U.S.C. §§ 362(b) & 553, 15 U.S.C. §§ 78eee(b)(2)(B)(ii), (iii). In the case of LBI, SIPC and the Trustee obtained the District Court's approval of a provision in the Order Commencing Liquidation that put the stay in place for 21 days to prevent liquidation of collateral under repos or securities lending agreements but

162. See LBI Liquidation Order at ¶ VIII.B-K (**Exhibit B**).

permitted SIPC and the Trustee to give their consent to allow creditors to exercise their rights within that period with the approval of SIPC and the Trustee.¹⁶³

288. SIPC and the Trustee did in fact receive during the twenty one-day period some requests from counterparties to exercise their liquidation rights and to remit the excess immediately to the Trustee. Given the data access issues described earlier in this Report, SIPC and the Trustee had incomplete information and therefore made consent conditional on representations by the requesting parties about the underlying facts – particularly that no customer property was involved – and agreements that permission was without prejudice to future assertion of rights. At least, however, SIPC and the Trustee were aware of who these parties were and were able to receive proceeds immediately and catalog which items needed to be investigated once the data access issues had improved; that was not necessarily the case with exempted counterparties, which, as described above, conducted termination and liquidation activities that were often totally undisclosed to the Trustee.

289. Many other counterparties owing several billion dollars to the estate did not contact the Trustee, and the Trustee has expended significant resources in identifying the

163.Paragraphs VI and VII of the LBI Liquidation Order provided:

“ORDERED that pursuant to 15 U.S.C. §§78eee(b)(2)(B)(ii) and (iii), and notwithstanding the provisions of 11 U.S.C. §§362(b) and 553, except as otherwise provided in this Order, all persons and entities are stayed, enjoined and restrained for a period of twenty-one (21) days, or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from enforcing liens or pledges against the property of LBI and from exercising any right of setoff, without first receiving the written consent of SIPC and the Trustee.

ORDERED that, pursuant to 15 U.S.C. § 78eee(b)(2)(C)(ii), and notwithstanding 15 U.S.C. § 78eee(b)(2)(C)(i), all persons and entities are stayed for a period of twenty-one (21) days, or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from foreclosing on, or disposing of, securities collateral pledged by LBI, whether or not with respect to one or more of such contracts or agreements, securities sold by LBI under a repurchase agreement, or securities lent under a securities lending agreement, without first receiving the written consent of SIPC and the Trustee.”

LBI Liquidation Order at ¶¶ VI-VII (**Exhibit B**).

parties and transactions, reconciling the amounts and negotiating recoveries. The passivity of these counterparties has not only created exposure but delay and uncertainty about the amount of property available for satisfaction of customer or other claims. The Trustee therefore recommends that policy-makers consider modifications to the stay exemption provisions and other rules that would provide greater transparency and thereby minimize the harm to the customers and creditors of the entity being liquidated from counterparties' actions, while at the same time minimizing the possibility of broader market effects in the event of broker-dealer collapse. These modifications would include:

(1) Extending the operation of the stay to prevent liquidation of collateral to currently exempted counterparties for a reasonable, but brief, period of time, (perhaps less than the twenty-one days in the LBI Order), following the commencement of the liquidation;

(2) Providing that SIPC or a SIPA trustee or other liquidator could consent to exercise of a counterparty's liquidation or other rights on certain conditions, or keep the stay in effect but provide the counterparty with adequate collateral on a mark-to-market basis or assurance of eventual payment. In exchange the counterparty would (a) supply information in the form of sworn representations to the satisfaction of SIPC and the trustee or other liquidator, (b) return any admitted or agreed excess to the liquidator, and (c) agree to clawback rights by acceptance of consents made without prejudice to future assertion of claims by the liquidator; and

(3) Providing that counterparties, whether or not they liquidate collateral to derivative or foreign exchange transactions, must provide information and reconciliations to SIPC, the trustee or other liquidator within the six month claims period, after which

any safe harbor protection or relief from the stay for their actions would be forfeited and the liquidator could seek all available remedies as well as enhanced interest, as explained below for unwind transactions generally.

290. At the very least, drawing the exemptions reflected in safe harbor provisions more narrowly, and clarifying that those adequately-collateralized counterparties will be protected as long as they deal proactively and in good faith will expand the comfort zone in which the Trustee or other liquidator is operating in the early days of the liquidation, and lead to a dialogue and exchange of information with lenders and counterparties, with the aim of assuring fairness and consistency while minimizing the deleterious impact of what is likely to be a distressed market. As noted above, this concept of keeping the automatic stay in effect but providing for consensual modification might also be extended to clearing banks which would have to at least consult SIPC or a SIPA Trustee or other liquidator before liquidating collateral, apprise them of relevant information, and seek agreement to terms that would increase transparency.

**I. Tailoring Safe Harbors To SIPA:
Achieving Fairness And Finality For Close-Outs**

291. The Trustee and his professionals are currently in the process of unwinding financial products that were transacted at LBI with broker-dealers, financial institutions, and other parties. The financial products include foreign exchange derivatives, repos, securities lending agreements and TBAs. Nearly all the counterparties are highly sophisticated parties that participated in complex transactions worth millions of dollars and as such, are fully aware of (i) their rights and obligations regarding the close-out of transactions with the Trustee following the commencement of the SIPA liquidation and (ii) their financial

exposure to the Trustee resulting from the close-out, including whether an LBI receivable or payable existed.

292. During the twenty-one day stay period in the Liquidation Order, a few — but only a few — of these LBI counterparties reached out to the Trustee to close out outstanding transactions. The Trustee’s professionals were required to expend tremendous effort and expense to determine what other counterparties had payables to the estate, send close-out letters to such counterparties and then conduct the reconciliation of the outstanding accounts. Even then, many of the counterparties were slow to respond to requests for information or support for their close-out calculation. For example, in the first year of the liquidation while the Trustee and his professionals had many other pressing tasks and were grappling with the informational problems described earlier in this Report, collections from financial product unwinds totaled approximately \$500 million, most of which resulted from parties with excess collateral seeking relief from the stay. In contrast, once the Trustee and his professionals could complete their preliminary review of the books and records of LBI and begin pursuing the counterparties, they succeeded in collecting four times as much — over \$2 billion — between August of 2009 and the present with many other collection efforts currently underway.¹⁶⁴

293. Delay in receiving funds at a time when they may be needed impedes the prompt and efficient liquidation of property and settlement of claims. Migration of knowledgeable staff and temporary or permanent loss of access to systems may compound these

164. The procedures the Trustee follows with respect to litigating or reaching settlement of close-outs are set forth in the Bankruptcy Court’s Order, Pursuant to Section 105(a) of the Bankruptcy Code, Approving and Authorizing Procedures to Unwind, Close-out and Reduce to Cash Receivables Owed By Trading Counterparties (LBI Docket No. 2078) (**Exhibit E**). As of July 26, 2010, sixty final settlements have been reached, fourteen of which have been of a size to require notice of filing with the Court, and approximately 45 now are being pursued that would require court approval.

negative consequences. The additional expense to the estate in having to investigate and search for potential receivables due from the unwind of financial products is considerable. The Trustee conservatively estimates that, through June 30, 2010, over 5,000 hours of accounting professional time and a substantial amount of legal as well as administrative staff time had to be expended in locating and researching amounts potentially owed by counterparties, contacting those counterparties, convincing them to share necessary information, and negotiating with them to cause them to pay amounts that they, themselves, sometimes recognized they owed to the estate. These costs have approached \$5 million, not including the costs of delay and uncertainty. All could have been avoided through a modicum of prompt cooperation and provision of basic information by these counterparties. The possibility also exists that, if parties in possession of the information and aware of the transactions do not come forward, some receivables will be missed because of the complexity of the broker-dealer's records or erroneous or confusing listings. For example, the books and records of the broker-dealer may indicate a small receivable or even net payable when in fact the counterparty owes substantial funds to the broker-dealer.

294. To avoid these results, the Trustee recommends that within a period such as the six month period for filing all claims, financial product counterparties be required to provide the Trustee or other liquidator information regarding their transactions with the broker-dealer, together with summaries setting forth: (i) the trade information, the close out date and amount believed to be owed; (ii) any collateral or other property of the estate being held by the counterparty; (iii) the valuation statements and the methodology employed in calculating valuation; and (iv) the nature and amount of any setoff or other deduction or adjustment the

counterparty intends to assert.¹⁶⁵ The submissions should include a representation by the counterparty that the submission is a complete list as well as copies of supporting contractual documents.

295. In exchange for providing their close-out information and paying what they believe (in good faith) to be the close-out amount due to the estate within the specified time frame, these counterparties could be permitted by statute to choose a close out date within 120 days after the Filing Date (unless an earlier close out date is contractually provided in which case such earlier close out date will be the applicable date), would retain their setoff rights and could be allowed by the trustee or SIPC to pay interest at a low rate, such as the Fed Funds rate. Non-complying counterparties would forfeit setoff rights, have to abide by a designated closeout date established by statute (such as the filing date or a narrow range of dates close to the filing date at the trustee's or other liquidator's option) and would pay interest at a higher rate (*i.e.*, the Fed Funds rate plus a certain fixed percentage).¹⁶⁶

296. The Trustee or SIPC or both should in turn provide to financial product counterparties, if possible, and post on their own and others' such as SIFMA's websites: (i) the updated mailing address to which the counterparties should send a copy of their termination notices, valuation statements, notices of default and other correspondence; (ii) the updated bank/securities account(s) information to which counterparties should make payments of cash or

165. The Trustee does not believe that legitimate setoff rights would include triangular setoff rights which, in LBI's case, would result in a windfall for counterparties and the LBHI estates at the expense of the LBI estate and ultimately its customers. The Trustee believes that the primacy of mutuality of setoff is clear under the present law. If litigation proves that belief to be mistaken, Congress should act to remove any doubt. *See* Notice of Filing of Motion of James W. Giddens, Trustee for The SIPA Liquidation of Lehman Brothers Inc., and The Securities Investor Protection Corporation for Leave to File Brief of *Amici Curiae* in Support of Lehman Brothers Holdings Inc. (LBI Docket No. 3595).

166. To the extent the counterparty had a net receivable from the broker-dealer, the information required could constitute its proof of claim.

transfer of securities, as applicable, and (iii) the name and address of the trustee's or other liquidator's legal counsel to whom legal questions should be directed.

297. A trustee or other liquidator should also (i) implement a standardized format (as determined by the financial/accounting professionals) as to the type of information that should be provided for each financial product, and (ii) require that such reconciliation information, in addition to the hard copies, be provided in a modifiable electronic format, *e.g.*, excel format (no pdfs). The Trustee and his professionals experienced numerous instances of counterparties sending their reconciliation information in a manner which had to be converted into a more usable format, causing waste of time and resources.

CONCLUSION

298. The Trustee respectfully submits this Preliminary Investigation Report and Recommendations for the information and consideration of the Court and other interested parties.

Dated: New York, New York
August 25, 2010

Respectfully submitted,

HUGHES HUBBARD & REED LLP

By: /s/ James B. Kobak, Jr.

A member of the firm
One Battery Park Plaza
New York, New York 10004
Telephone: (212) 837-6000
Facsimile: (212) 422-4726
Email: kobak@hugheshubbard.com

Attorneys for James W. Giddens,
Trustee for the SIPA Liquidation of the Business of
Lehman Brothers Inc.

EXHIBIT A

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re:

LEHMAN BROTHERS INC.,

Debtor.

Case No. 08-01420 (JMP) SIPA

ORDER GRANTING AUTHORITY TO ISSUE SUBPOENAS FOR THE PRODUCTION OF DOCUMENTS AND THE EXAMINATION OF THE DEBTOR'S CURRENT AND FORMER OFFICERS, DIRECTORS AND EMPLOYEES, AND OTHER PERSONS

Upon the motion (the "Motion") of James W. Giddens (the "Trustee"), as Trustee for the liquidation of the business of Lehman Brothers Inc. ("LBI"), pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), for an order authorizing the Trustee to issue subpoenas (each a "Subpoena") for the production of documents and the examination of the current and former officers, directors, employees, and affiliates of LBI, and other persons or entities with relevant information including, without limitation, LBI's lenders, investors, and other financial transaction counterparties to transactions with LBI (collectively, the "Witnesses"); and the Court finding that adequate notice of the Motion having been given; and it appearing that no other notice need be given; and after due deliberation and sufficient cause appearing therefore, it is

ORDERED that the Motion is GRANTED; and it is further

ORDERED, that the Trustee is authorized, pursuant to Bankruptcy Rule 2004, to issue such Subpoenas as may be necessary to compel the production of documents and the testimony of Witnesses in connection with his investigation of LBI; and it is further

ORDERED, that the Trustee shall serve each Subpoena and a copy of this Order on the target of the Subpoena, with copy to (i) the Securities Investor Protection Corporation, (ii)

the Securities and Exchange Commission, (iii) the Internal Revenue Service, and (iv) the United States Attorney for the Southern District of New York; and it is further

ORDERED, that the Trustee shall cooperate fully with the U.S. Department of Justice, and any other federal agency designated by them (collectively, the “Government”), in any matter that the Government is currently or in the future may be investigating regarding LBI, its management or its financial condition. The Trustee shall use best efforts to coordinate with the Government in order to avoid unnecessary interference with any investigation conducted by the Government. The Trustee will follow a reasonable protocol to be established jointly with the Government for the sharing of information and such sharing shall be subject to appropriate conditions to protect LBI’s estate, including but not limited to, the preservation of the attorney-client privilege and protections of the attorney work product doctrine. If the Trustee and the Government disagree as to the appropriateness of a proposed action to be taken pursuant to this Order, the Trustee reserves the right to seek a determination from the Court; and it is further

ORDERED, that the Trustee shall file with the Court an affidavit or declaration or service for each Subpoena he serves; and it is further

ORDERED, that Witnesses are directed to produce, on a rolling basis, all responsive documents described in the Trustee’s Subpoena such that all responsive documents are received by the Trustee within ten (10) days of the service of a Subpoena upon such Witness (unless otherwise agreed by the Trustee), subject to any documents withheld under a claim of privilege; and it is further

ORDERED, that if a Witness withholds the production of any documents to the Trustee based upon a claim of privilege, such Witness is directed to provide counsel for the Trustee with a privilege log, containing the information required under Bankruptcy Rule 7026,

within ten (10) days of the service of a Subpoena upon the Witnesses (unless otherwise agreed by the Trustee); and it is further

ORDERED, that the Witness is directed to submit to oral examination upon reasonable notice and, absent other agreement with the Trustee, in no event more than fifteen (15) days from the date of the service of a deposition Subpoena upon such Witness; and it is further

ORDERED, that nothing herein shall limit the rights of any Witness or any other party under applicable law to object to or oppose any Subpoena the Trustee may serve upon such Witness; and it is further

ORDERED, that this Court shall retain jurisdiction to resolve any disputes arising or related to this Order including any discovery disputes that may arise between or among the parties and to interpret, implement and enforce the provisions of this Order; and it is further

ORDERED, that in accordance with Bankruptcy Rules 2004 and 9016, the Clerk of this Court shall issue Subpoenas, signed but otherwise in blank, as requested by the Trustee; and it is further

ORDERED, that this Order is without prejudice to the Trustee's right to file further motions seeking additional documents and testimony pursuant to Bankruptcy Rule 2004(a) or any other applicable law.

Dated: January 15, 2009
New York, New York

/s/ James M. Peck

HONORABLE JAMES M. PECK
UNITED STATES BANKRUPTCY JUDGE

EXHIBIT B

LEHMAN BROTHERS

08 CIV 81197

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

**SECURITIES INVESTOR PROTECTION
CORPORATION,**

Plaintiff-Applicant,

v.

LEHMAN BROTHERS INC.

Defendant.

Civil Action No. 08-__

ORDER COMMENCING LIQUIDATION¹

On the Complaint and Application of the Securities Investor Protection Corporation ("SIPC"), it is hereby:

I. ORDERED, ADJUDGED and DECREED that the customers of the defendant Lehman Brothers Inc. ("LBI") are in need of the protection afforded by the Securities Investor Protection Act of 1970, as amended ("SIPA"). 15 U.S.C. §78aaa et seq.

II. ORDERED that pursuant to 15 U.S.C. §78eee(b)(3), James W. Giddens is appointed Trustee (the "Trustee") for the liquidation of the business of LBI with all the duties and powers of a trustee as prescribed in SIPA, and the law firm of Hughes Hubbard & Reed LLP is appointed counsel for the Trustee. The Trustee shall file a fidelity bond satisfactory to the Court in the amount of \$100,000.00.

1. The "LBI Liquidation Order"

III. ORDERED that all persons and entities are notified that, subject to the other provisions of 11 U.S.C. §362, the automatic stay provisions of 11 U.S.C. §362(a) operate as a stay of:

- A. the commencement or continuation, including the issuance or employment of process, of a judicial, administrative or other proceeding against LBI that was or could have been commenced before the commencement of this proceeding, or to recover a claim against LBI that arose before the commencement of this proceeding;
- B. the enforcement against LBI or against property of the estate of a judgment obtained before the commencement of this proceeding;
- C. any act to obtain possession of property of the estate or property from the estate;
- D. any act to create, perfect or enforce any lien against property of the estate;
- E. any act to create, perfect or enforce against property of LBI any lien to the extent that such lien secures a claim that arose before the commencement of this proceeding;
- F. any act to collect, assess or recover a claim against LBI that arose before the commencement of this proceeding;
- G. the setoff of any debt owing to LBI that arose before the commencement of this proceeding against any claim against LBI; and
- H. the commencement or continuation of a proceeding before the United States Tax Court concerning LBI's tax liability for a taxable period the Bankruptcy Court may determine.

IV. ORDERED that all persons and entities are stayed, enjoined and restrained from directly or indirectly removing, transferring, setting off, receiving, retaining, changing, selling, pledging, assigning or otherwise disposing of, withdrawing or interfering with any assets or property owned, controlled or in the possession of LBI, including but not limited to the books and records of LBI, and customers' securities and credit balances, except for the purpose of effecting possession and control of said property by the Trustee.

V. ORDERED that pursuant to 15 U.S.C. §78eee(b)(2)(B)(i), any pending bankruptcy, mortgage foreclosure, equity receivership or other proceeding to reorganize, conserve or liquidate LBI or its property and any other suit against any receiver, conservator or trustee of LBI or its property, is stayed.

VI. ORDERED that pursuant to 15 U.S.C. §§78eee(b)(2)(B)(ii) and (iii), and notwithstanding the provisions of 11 U.S.C. §§362(b) and 553, except as otherwise provided in this Order, all persons and entities are stayed, enjoined and restrained for a period of twenty-one (21) days, or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from enforcing liens or pledges against the property of LBI and from exercising any right of setoff, without first receiving the written consent of SIPC and the Trustee.

VII. ORDERED that, pursuant to 15 U.S.C. §78eee(b)(2)(C)(ii), and notwithstanding 15 U.S.C. §78eee(b)(2)(C)(i), all persons and entities are stayed for a period of twenty-one (21) days, or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from foreclosing on, or disposing of, securities collateral pledged by LBI, whether or not with respect to one or more of such contracts or agreements, securities sold by LBI under a repurchase agreement, or securities lent

under a securities lending agreement, without first receiving the written consent of SIPC and the Trustee.

VIII. ORDERED that the stays set forth in paragraphs three – six shall not apply

to:

- A. any suit, action or proceeding brought or to be brought by the United States Securities and Exchange Commission (“Commission”), the Commodity Futures Trading Commission (“CFTC”), or any self-regulatory organization of which LBI is now a member or was a member within the past six months; or
- B. the exercise of a contractual right of a creditor to liquidate, terminate, or accelerate a securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, or master netting agreement, as those terms are defined in 11 U.S.C. §§101, 741, and 761, to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection with one or more of such contracts or agreements, or to foreclose on any cash collateral pledged by LBI, whether or not with respect to one or more of such contracts or agreements; or
- C. the exercise of a contractual right of any securities clearing agency to cause the liquidation of a securities contract as defined in 11 U.S.C. §741(7) and the contractual right of any derivatives clearing organization to cause the liquidation of a commodity contract as defined in 11 U.S.C. §761(4); or

- D. the exercise of a contractual right of any stockbroker or financial institution, as defined in 11 U.S.C. §101, to use cash or letters of credit held by it as collateral, to cause the liquidation of its contract for the loan of a security to LBI or for the pre-release of American Depository Receipts or the securities underlying such receipts; or
- E. the exercise of a contractual right of any “repo” participant, as defined in 11 U.S.C. §101, to use cash to cause the liquidation of a repurchase agreement, pursuant to which LBI is a purchaser of securities, whether or not such repurchase agreement meets the definition set forth in 11 U.S.C. §101(47); or
- F. the exercise of a contractual right, as such term is used in 11 U.S.C. §555, in respect of (i) any extension of credit for the clearance or settlement of securities transactions or (ii) any margin loan, as each such term is used in 11 U.S.C. §741(7), by a securities clearing bank, or the exercise of a contractual right as such term is used in 11 U.S.C. §556 in respect of any extension of credit for the clearance or settlement of commodity contracts by a commodity broker as defined in 11 U.S.C. §101(6). As used herein, “securities clearing bank” refers to any financial participant, as defined in 11 U.S.C. §101(22A), that extends credit for the clearance or settlement of securities transactions to one or more Primary Government Securities Dealers designated as such by the Federal Reserve Bank of New York from time to time; or

- G. the exercise of a contractual right, as such term is used in 11 U.S.C. §555, by a person (or such person's agent) in respect of securities that were sold to such person by LBI pursuant to a repurchase transaction (as such term is used in 11 U.S.C. §741(7) and regardless of whether such transaction is a repurchase agreement within the meaning of 11 U.S.C. §101(47)) with LBI that is subject to a Custodial Undertaking in Connection With Repurchase Agreement among LBI, JPMorgan Chase Bank N.A. and such person (or such person's agent); or
- H. the exercise of a contractual right, as such term is used in 11 U.S.C. §555, by the Federal Reserve Bank of New York; or
- I. any setoff or liquidating transaction undertaken pursuant to the rules or bylaws of any securities clearing agency registered under section 17A(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78q-1(b), or any derivatives clearing organization registered under section 5b of the Commodity Exchange Act, 7 U.S.C. §7a-1, or by any person acting under instructions from and on behalf of such a securities clearing agency or derivatives clearing organization; or
- J. any settlement transaction undertaken by such securities clearing agency using securities either (i) in its custody or control, or (ii) in the custody or control of another securities agency with which it has a Commission approved interface procedure for securities transactions settlements, provided that the entire proceeds thereof, without benefit of any offset, are promptly turned over to the Trustee; or

K. any transfer or delivery to a securities clearing agency or derivatives clearing organization by a bank or other depository, pursuant to instructions given by such clearing agency or derivatives clearing organization, of cash, securities, or other property of LBI held by such bank or depository subject to the instructions of such clearing agency or derivatives clearing organization and constituting a margin payment as defined in 11 U.S.C. §741(5); or

IX. ORDERED that the stays set forth in paragraphs three – seven above shall not apply to the exercise of any rights specified in Sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560 and/or 561 of the Bankruptcy Code by Barclays Capital Inc. or any affiliate thereof (or any agent of Barclays Capital Inc. or any affiliate thereof), including without limitation rights of foreclosure and disposition referred to in 15 U.S.C. Section 78eee(b)(2)(C)(ii), with respect to any transaction (or any extension, assignment, novation or rollover of such transaction) entered into on or prior to the earlier of (i) consummation of the transactions contemplated by the Asset Purchase Agreement dated September 16, 2008 among Barclays Capital Inc., Lehman Brothers Inc., Lehman Brothers Holdings Inc. and LB 745 LLC and (ii) September 24, 2008;

X. ORDERED that pursuant to 11 U.S.C. §721, the SIPA Trustee is authorized to operate the business of LBI to: (a) conduct business in the ordinary course until 6:00 p.m. on September 19, 2008, including without limitation, the purchase and sales of securities, commodities futures and option transactions, and obtaining credit and incurring debt in relation thereto; (b) complete settlements of pending transactions, and to take other necessary and appropriate actions to implement the foregoing, in such accounts until 6:00 p.m. on

September 23, 2008; and (c) take other action as necessary and appropriate for the orderly transfer of customer accounts and related property.

XI. ORDERED that the Clerk of the Court is directed to immediately open the docket in this proceeding and that this Order be entered on the docket immediately.

XII. ORDERED that the Clerk of the Court is directed to produce seventy-five (75) certified copies of this Order, at the regular cost, immediately upon the Order's entry onto the docket.

XIII. ORDERED that pursuant to 15 U.S.C. §78eee(b)(4), this liquidation proceeding is removed to the United States Bankruptcy Court for the Southern District of New York, and shall be transmitted electronically to by the Clerk of the Court immediately upon entry on the docket.

XIV. ORDERED that the Trustee is authorized to take immediate possession of the property of LBI, wherever located, including but not limited to the books and records of LBI, and to open accounts and obtain a safe deposit box at a bank or banks to be chosen by the Trustee, and the Trustee may designate such of his representatives who shall be authorized to have access to such property.

Date: September 19, 2008

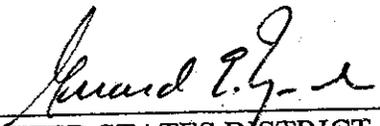
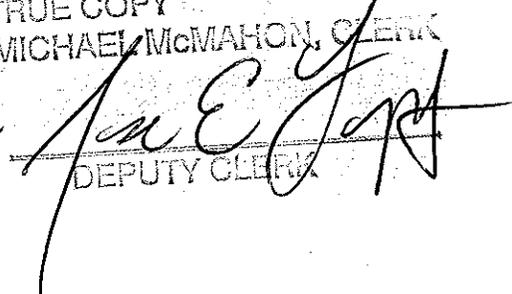

UNITED STATES DISTRICT JUDGE
A TRUE COPY
J. MICHAEL McMAHON, CLERK
BY 
DEPUTY CLERK

EXHIBIT C

Trustee’s Preliminary Investigation Report And Recommendations
Chronology – 1987 to September 22, 2008

	Date/Time	Background
1	1987	Shearson Lehman Brothers Holdings Inc. conducts initial public offering of \$18 million shares of common stock, generating \$628 million in capital. American Express Co. retains 61% interest in SLBHI.
2	7/30/1993	Shearson Lehman Brothers Inc. completes sale of domestic retail brokerage and asset management businesses to Smith Barney, Harris Upham & Co.
3	8/02/1993	Shearson Lehman Brothers Holdings Inc. changes name to Lehman Brothers Holdings Inc., and Shearson Lehman Brothers Inc. changes name to Lehman Brothers Inc.
4	5/02/1994	Shearson spins off Lehman by way of initial public offering.
5	1996	Lehman’s “Executive Committee” is created
6	6/15/2000	LBI and Chase execute a Clearance Agreement governing the Chase-LBI clearing relationship. The Clearance Agreement also provides for the extension of credit to LBI by Chase at Chase’s sole discretion.
7	5/29/2001	LBI pays a \$1.05 billion dividend to LBHI. LBHI approves the \$800 million Subordinated Loan Agreement between LBHI and LBI. LBI is to send the net amount of the dividend, \$250 billion, as cash to LBHI.
8	8/29/2002	LBI pays a \$1 billion dividend to LBHI. LBHI approves the \$800 million increase in the Subordinated Loan Agreement between LBHI and LBI. LBI is to send the net amount of the dividend, \$200 million, as cash to LBHI.
9	2003	Lehman acquired the fixed income business of Lincoln Capital Mgmt. Co., which became Lehman’s fixed income investment management arm, later known as Lehman Brothers Asset Management.
10	10/2003	Lehman acquires Neuberger Berman, a money management firm for wealthy individuals and institutional investors.
11	10/03/2003	First Supplemental Indenture whereby LBHI agrees to act as guarantor for debt securities issued by LBI.
12	10/14/2003	Second Supplemental Indenture whereby LBHI agrees to act as guarantor for debt securities issued by LBI.
13	11/20/2003	Third Amendment to 5/29/2001 Subordinated Loan Agreement - Cash between LBI and LBHI. This amendment increases the loan amount from \$2.4 billion to \$2.9 billion.
14	11/20/2003	LBI pays a \$1 billion dividend to LBHI. LBHI approves a \$500 million increase in the Subordinated Loan Agreement between LBHI and LBI. LBI is to send the net amount of the dividend, \$500 million, as cash to LBHI.
15	2/16/2004	Effective date of excess SIPC surety bond issued by Capco. LBI’s intent is to provide its customers with protection in excess of that afforded by SIPA in the event that a customer’s other receipts do not fully satisfy its net equity claim. The surety bond is subsequently renewed as of February 15, 2005, 2006, 2007 and February 16, 2008, with an expiration date of February 16, 2009.
16	5/2004	LBI infuses \$200 million into LBSF by way of \$150 million cash dividend from LCPI and \$50 million cash dividend from RIBCO to LBI, then down to LBSF.
17	6/07/2004	LBHI guarantees the obligations of its subsidiaries or affiliates to Citibank. LBHI defines the guarantee to include only Lehman Brothers Holdings PLC, LB Securities Asia Ltd., LBSF, LBJ, LBIE, LBCC Asia Ltd., and Lehman Brothers Bankhaus AG. LBI was not included.
18	11/24/2004	LBI pays a \$1.2 billion dividend to LBHI. LBHI approves the \$500 million increase from the 9/30/1996 Cash Subordination Agreement. LBI will send the net amount of the dividend, \$700 million, as cash to LBHI.
19	10/03/2005	Chase and LBI enter into the Cash Collateral Agreement that secures LBI’s obligations arising from Chase’s provision of clearing services to LBI.

	Date/Time	CSE PERIOD (POST-2005)
20	12/01/2005	SEC authorizes Lehman to begin operating as a consolidated supervised entity (“CSE”), which enables the firm to use a risk-based method of computing net capital while giving the SEC oversight.
21	2/2007	Lehman purchases interests in GLG Partners (at the time Europe’s largest hedge fund), Marble Bar Asset Mgmt., Spinnaker Capital, Blue

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	CSE PERIOD (POST-2005)
		Bay Asset Mgmt., Grange Securities (one of the largest CDO sellers in Australia), and Ospraie (a U.S. commodity fund).
22	3/13/2007	Audit Committee is informed about Lehman’s U.S. mortgage businesses, particularly the subprime mortgage businesses, and the firm’s purchase of a 20% interest in DE Shaw.
23	8/2007	Lehman’s total capital ratio declines to 10.5% in August 2007, from 18.2% in early 2006.
24	8/02/2007	For the first time, auctions for two LBI-led taxable auction rate securities (“ARS”), issued by Ram Re and Radian, fail.
25	8/20/2007	Corporate taxable ARS market experiences widespread auction failure.
26	8/28/2007	LBI makes a \$500 million capital infusion to LCPI, while LBI simultaneously receives a \$500 million dividend payment from LBSF.
27	9/11/2007	Finance and Risk Committee is informed about the Firm’s risk exposure to the subprime mortgage market, high-yield bonds, leveraged loans, securitized products, commercial paper, and hedge funds. Committee is updated about Lehman’s balance sheet and capital management. It is noted that Lehman had a record level of liquidity and cash capital surplus at the end of the 3rd quarter of 2007. Committee is informed about Lehman’s credit ratings, including the June 2007 ratings upgrade and recent affirmation from Fitch and affirmations of credit ratings by both Standard & Poor’s and Moody’s in August 2007.
28	12/31/2007	LBI’s Form 17a-5 Focus Report reflects that as of 12/31/07, LBI has: <ul style="list-style-type: none"> • Total Assets of \$470 billion, of which \$465 billion are “allowable” • Total Liabilities of \$465 billion • \$1.2 billion Segregated Cash • Excess Net Capital of \$2.46 billion • \$3.1 billion in Reserve Bank Account pursuant to Rule 15c3-3
29	1/2008	The SEC begins to inspect the valuation procedures of all CSE firms to ensure that the firms are complying with internal controls, to compare procedures across the firms, and to provide feedback. The SEC inspection found significant problems at Lehman, including understaffing of their Price Valuation Group and an asset pricing function that was overly “process driven.”
30	1/22/2008	Lehman experiences its first, isolated failures in the municipal ARS market. Although the next auction of these issues functioned successfully, the municipal auction rate market, as well as student loan auction rate products, across the industry, experienced failures over the next three weeks.
31	1/29/2008	Finance and Risk Committee is told that Lehman’s net leverage increased to 16.1x at year-end, although this increase was at a lesser rate than Lehman’s peers. Committee is also told that Lehman has maintained compliance with its conservative funding framework despite challenging credit markets, and that Lehman had record liquidity at fiscal year-end.
32	1/31/2008	LBI’s Form 17a-5 Focus Report reflects that as of 1/31/08, LBI has: <ul style="list-style-type: none"> • Total Assets of \$484 billion, of which \$481.5 billion are “allowable” • Total Liabilities of \$480 billion • \$1.2 billion Segregated Cash • Excess Net Capital of \$2.646 billion • \$2.23 billion in Reserve Bank Account pursuant to Rule 15c3-3
33	2/2008	LBI requests that Chase provide a daily Net Free Equity (“NFE”) snapshot report in order to allow LBI to obtain better estimates of its position. NFE was the market value of securities pledged to Chase plus any unsecured credit line Chase extended to LBI minus cash advanced by Chase to LBI.
34	2/01/2008	Korea Development Bank (“KDB”) expresses interest in making a private investment in Lehman similar to the \$2 billion deal that Korea Investment Corp. made with Merrill Lynch.
35	2/21/2008	Lehman worries about changes in its credit default swap spreads as a result of rumors that the Firm is going to have writedowns. Increase

Trustee's Preliminary Investigation Report And Recommendations

Chronology -- 1987 to September 22, 2008

	Date/Time	CSE PERIOD (POST-2005)
		in spreads makes access to capital markets, such as in Asia, more difficult. Counterparties raise concerns to Lehman about writedowns.
36	2/29/2008	<p>LBI's Form 17a-5 Focus Report reflects that as of 2/29/08, LBI has:</p> <ul style="list-style-type: none"> • Total Assets of \$437 billion, of which \$433.6 billion are "allowable" • Total Liabilities of \$432 billion • \$884 million Segregated Cash • Excess Net Capital of \$2.5 billion • \$4.75 billion in Reserve Bank Account pursuant to Rule 15c3-3

	Date/Time	THE BEAR STEARNS CRISIS
37	3/12/2008	Dealer counterparties are refusing to accept the assignment of Lehman or Bear Stearns trades.
38	3/14/2008	Lehman executives express concerns internally about ability to survive if Bear Stearns collapses.
39	3/15/2008	Government monitors from the SEC and the Federal Reserve take up residence at Lehman to monitor Lehman's financial condition with particular focus on liquidity.
40	3/16/2008	Bear Stearns is sold to JP Morgan for \$2 a share pending shareholder approval (price is later adjusted to \$10/share). In order to facilitate the deal, the Fed agrees to give a \$30 billion loan on favorable terms to JP Morgan thereby limiting JP Morgan's risk exposure to \$1 billion. Bear Stearns collapse is in part due to having had two of its hedge funds lose \$1.6 billion on subprime mortgage bets.
41	3/16/2008	The Federal Reserve Board of Governors grants the FRBNY authority to establish the Primary Dealer Credit Facility ("PDCF") as a means to provide liquidity to investment banks. The PDCF was designed to allow the FRBNY to provide collateralized loans to broker-dealers such as LBI and was structured as an overnight facility to provide short-term secured financing.
42	3/17/2008	Lehman's stock plummets to around \$20 per share before closing at \$31.75 – another "near-death experience," a Lehman banker called it – as investors feared that the firm would be the next to fall.
43	3/18/2008	"Dear Client" letter issued to PIM customers commenting on recent market volatility and asserting the strength of the firm's liquidity position. Customers are told that their assets "are not subject to the claims of the Firm's creditors," and that SIPC coverage exists "in the case of a shortfall of the covered assets."
44	3/25/2008	Finance and Risk Committee is informed about recent market events leading to the sale of Bear Stearns to Chase. The factors leading to the sale of Bear Stearns are described, and differences between the liquidity and funding practices of Bear Stearns and Lehman are highlighted. The Committee asked questions about the new Federal Reserve primary dealer credit facility, exposure to monoline insurers, activity levels of the prime brokerage unit, and the intercompany transfer of assets to Lehman Brothers Bankhaus AG.
45	3/26/2008	Lehman officers discuss potential that secured lines of credit might be pulled, difficulties in making deliveries at an appropriate pace, and problems with counterparty risk and repo. One officer writes, "I'm not sure we are set up to weather this one." Another officer expresses concern that the problem lies with Lehman's dependency on repo and the scale of real estate related positions.
46	3/26/2008 08:57 AM	Equity and FID business slowing down with clients such as UBS, CS, DB, ING no longer doing business with Lehman and some clients refusing to have Lehman as the calculation agent in trades.
47	3/27/2008 01:58 PM	LBI requests a paydown from LBHI of \$450 million to provide a capital infusion into various subsidiaries in which LBI has, or will have, a negative investment. The funds received into LBI are subsequently paid to LCPI, LB I Group, and RIBCO.
48	3/27/2008 04:16 PM	Rumors circulate outside the firm that Lehman collateral is not being accepted by the Fed.
49	3/31/2008	<p>LBI's Form 17a-5 Focus Report reflects that as of 3/31/08, LBI has:</p> <ul style="list-style-type: none"> • Total Assets of \$488 billion, of which \$485 billion are "allowable"

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	THE BEAR STEARNS CRISIS
		<ul style="list-style-type: none"> • Total Liabilities of \$483 billion • \$1.9 billion Segregated Cash • Excess Net Capital of \$3.2 billion • \$2.6 billion in Reserve Bank Account pursuant to Rule 15c3-3
50	4/09/2008 03:42 PM	Lehman experiences problems with its credit lines at Chase. Despite having received \$950 million in collateral, Chase requests an additional \$2 billion from Lehman.
51	4/21/2008	Lehman performs a liquidity stress test, which finds that the liquidity risk for the broker-dealer affiliates is less of a concern because the repo market is more reliable than the unsecured market.
52	4/30/2008	LBI’s Form 17a-5 Focus Report reflects that as of 4/30/08, LBI has: <ul style="list-style-type: none"> • Total Assets of \$398 billion, of which \$396 billion are “allowable” • Total Liabilities of \$394 billion • \$2.1 billion Segregated Cash • Excess Net Capital of \$3.5 billion • \$5.5 billion in Reserve Bank Account pursuant to Rule 15c3-3
53	5/2008	LCPI receives a cash infusion of \$150 million in response to a significant write-down of securities backed by California real estate. LBHI transfers the cash to LBI, which transfers it back to LBHI (for the benefit of LCPI).
54	5/2008	LBSF receives a cash infusion of \$100 million. LBHI transfers the cash to LBI, which in turn transfers it to LBSF.
55	5/05/2008 04:17 PM	According to a CNBC report, Lehman is planning layoffs in the coming days.
56	5/07/2008 08:30 AM	Finance and Risk Committee discusses financing, liquidity, and the financial world’s overall market conditions. The prime brokerage business experienced a decline of approximately \$3 billion in customer free credits since March 14, primarily caused by hedge funds customers’ redemptions and lower leverage. It was discussed that this would have no impact on Lehman’s liquidity as Lehman does not include customer free credits in its liquidity pool calculation.
57	5/16/2008 05:02 PM	Matthew Lee sends a letter to Lehman executives alleging financial misstatements and accounting improprieties.
58	5/20/2008 03:54 PM	Lehman lays off nearly 5% of its workers globally. The latest cuts are in addition to the layoffs of more than 5,000 people since mid-2007.
59	5/21/2008	David Einhorn makes a speech at the Ira W. Sohn Investment Research Conference declaring that his firm had a short position on Lehman, “not only because Lehman had fudged its numbers but because its recklessness had put the financial system as we know it at grave risk.”
60	5/26/2008 08:54 AM	Lehman officers discuss potential parties interested in buying part of Lehman. One notes that the KDB situation sounds promising but GE or AIG would be preferable.
61	5/28/2008 09:46 PM	Lehman officers discuss opportunities for selling a partial ownership stake in LBHI in preparation for a meeting with KDB.
62	5/30/2008 03:48 PM	LBI plans to provide a \$500 million capital infusion to LCPI, LB I Group, and LBSF “to eliminate any current and/or potential negative investment.”
63	5/31/2008	LBI’s Form 17a-5 Focus Report reflects that LBI has, as of 5/31/08: <ul style="list-style-type: none"> • Total Assets of \$320 billion, \$317 billion of which were “allowable” • Total Liabilities of \$316 billion • Over \$2 billion segregated cash • Excess net capital of \$3.1 billion • Over \$3.8 billion in Reserve Bank Accounts Pursuant to Rule 15c3-3
64	6/05/2008 07:19 PM	Lehman officers discuss seeking interest of Entessa, Societe Generale and HSBC in possible Lehman investment.

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	THE BEAR STEARNS CRISIS
65	6/09/2008 06:48 AM	Lehman announced that continued challenging market conditions will result in an expected net loss of approximately \$2.8 billion, or (\$5.14) per common share (diluted) for the second quarter 2008 and net revenues (total revenues less interest expense) of (\$0.7) billion.
66	6/12/2008	Joseph Gregory and Erin Callan resign. Ian Lowitt, Chief Administrative Officer, becomes CFO. Bart McDade, Global Head of Equities, becomes Chief Operating Officer and President, replacing Joseph Gregory.
67	6/12/2008	Lehman places a \$2 billion “comfort deposit” with Citigroup to allay Citigroup’s intraday risk concerns.
68	6/19/2008	Executive Committee of the Board of Directors authorizes and approves the issuance of \$4 billion of additional common stock and \$2 billion of a new series of preferred stock, 8.75% non-cumulative mandatory convertible preferred stock, series Q. This was part of a plan to raise additional capital in light of Lehman’s poor 2nd Quarter earnings.
69	6/30/2008	LBI’s Form 17a-5 Focus Report reflects that LBI has, as of 6/30/08: <ul style="list-style-type: none"> • Total Assets of \$436 billion, of which \$433 billion were “allowable” • Total Liabilities of \$431 billion • Segregated cash of \$2.5 billion • Excess net capital of \$3.2 billion • Over \$4.9 billion in Reserve Bank Accounts Pursuant to Rule 15c3-3
70	7/10/2008 09:57 PM	Lehman officers discuss possible mergers/acquisitions by GE and BofA, but describe KDB as the preferred option, offering the greatest chance for Lehman to operate independently but with a reliable source of external funding.
71	7/12/2008 09:31 AM	Lehman officers discuss the possibility of LBHI becoming a bank holding company but that this needs to be accompanied by an announcement on 7/14/08 that LBHI will sell its asset management business and mortgage backed securities, thereby recovering several billion dollars in excess of the equity assigned to those assets. Lehman would use those sales to conduct a large scale buy-back of stock to essentially privatize Lehman. Officers consider suggesting that Lehman should first see if HSBC is willing to bid for Lehman at \$25 a share.
72	7/18/2008 05:08 PM	Lehman targets 8/11/08 as the date to announce SpinCo. SpinCo. was LBHI’s plan to spin-off its commercial real estate portfolio to a stand-alone company, which would then be owned by Lehman shareholders but operate independently of LBHI.
73	7/22/2008	Executive Committee of the Board of Directors authorizes the election of H. H. McDade III as President and Chief Operating Officer and the election of I. Lowitt as Chief Financial Officer and Controller. Also elected are: G. Donini, Senior Vice President and Global Head of Equities; M. Gelband, Senior Vice President and Global Head of Capital Markets; D. Goldfarb, Chief Strategy Officer; and A. Kirk, Senior Vice President and Global Head of Principal Investing.
74	7/28/2008 11:29 AM	Lehman officers are updated on potential suitors for IMD. Another possibility discussed is the “KKR option” whereby Lehman Private Equity (LBPE) buys IMD.
75	7/29/2008 11:54 AM	LBI sustains a pre-tax loss of \$350 million as of 7/24. In response, LBHI is considering infusing additional capital into LBI for July depending on the amount and timing of write-downs.
76	7/31/2008	The major investment banks send a letter to T. Geithner updating him on the continued progress that they as a group have made in improving the credit and equity derivative market participant practices and in expanding coordinated efforts to additional asset classes. The letter is signed by senior management of Bank of America, Barclays, BNP Paribas, Citigroup, Credit Suisse, Deutsche Bank, Dresdner Kleinwork, Goldman Sachs, HSBC, JP Morgan Chase, Lehman Brothers, and other investment banks. ISDA, MFA and SIFMA are also signatories.
77	7/31/2008	LBI’s Form 17a-5 Focus Report reflects that LBI has, as of 7/31/08: <ul style="list-style-type: none"> • Total Assets of \$332 billion, of which \$329 billion were “allowable” • Total Liabilities of \$328 billion

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

Date/Time		THE BEAR STEARNS CRISIS
		<ul style="list-style-type: none"> • Segregated cash of \$5 billion • Excess net capital of \$3.2 billion • Nearly \$5.2 billion in Reserve Bank Accounts Pursuant to Rule 15c3-3.
78	7/31/2008 11:41 AM	LBI requests a paydown from LBHI of \$375 million to provide a capital infusion into various subsidiaries in which LBI has a negative investment. The funds received into LBI will be subsequently paid to LCPI and LB I Group.

Date/Time		AUGUST 2008
79	8/2008	The Bank of New York Mellon (“BNYM”) requests collateral from Lehman due to BNYM’s perception of its intraday credit risk.
80	8/08/2008 12:51 PM	Lehman considers corporate reorganization that would move LBSF and LCPI, but not LB I Group, out of LBI. LBSF and LCPI have significant p/l fluctuations, which raises concerns for LBI.
81	8/10/2008 12:05 PM	Lehman prepares for a meeting with the SEC about the creation of SpinCo.
82	8/14/2008 01:09 PM	Lehman speaks with T. Geithner about a possible exemption for LBCB from regulations under Rule 23A. Lehman stresses that the exemption be granted quickly. Geithner defers to FDIC.
83	8/14/2008 01:57 PM	Lehman submits a draft request for \$17.5 billion of assets to be transferred under the 23A exemption to LBCB, with final submission occurring after FDIC feedback. The purpose of the request is to accelerate the growth and profitability of the Bank.
84	8/14/2008 03:39 PM	Lehman tells Fitch Ratings that the regulators had made a request to do a stress test and found that Lehman had an excess liquidity position of \$15 billion as of the end of June.
85	8/14/2008 4:57 PM	LBI loses approximately \$835 million pre-tax in July.
86	8/22/2008 09:20 PM	LBI’s internal reorganization efforts to move LBSF and LBI out of LBI are hampered because entities that are capital deficient cannot be moved out of the LBI family without regulatory or tax consequences, and because of the logistics involved.
87	8/28/2008 12:57 PM	LBI requests a paydown from LBHI of \$1.1 billion to provide a capital infusion into various subsidiaries in which LBI has, or will have, a negative investment. The funds received by LBI will subsequently be paid to LCPI and LB I Group.
88	8/28/2008 12:59 PM	The <i>New York Times</i> reported that Lehman plans to lay off around 1,500 employees before third-quarter results are announced in mid-September.
89	8/29/2008	Lehman enters into three agreements with Chase providing a guarantee to Chase for its clearing activities for the obligations of LBI, LCPI, LOTC, LBIW and LBJ. Prior to the amendment to the Clearance Agreement, LBHI did not guarantee LBI obligations.
90	8/30/2008	Concerned by rumors that Lehman would either go out of business over the weekend or bring in an investor, the CME seeks further dialogue with Lehman.
91	8/31/2008	According to Draft Form 17a-5 Focus Report, LBI has as of 8/31/08: <ul style="list-style-type: none"> • Total Assets of \$302 billion, of which \$298.7 billion were “allowable” • Total Liabilities of \$298 billion • Segregated cash of \$3 billion • Excess net capital of \$3.3 billion • Nearly \$5 billion in Reserve Bank Accounts Pursuant to Rule 15c-3.

Date/Time		THE FIRST TWO WEEKS OF SEPTEMBER
92	9/03/2008 04:00 PM	LBHI Board of Directors is updated about market conditions and Lehman’s third quarter results. Specific points included: (1) updates on the status of the proposed spin-off of commercial real estate assets; (2) updates on discussions with two potential foreign investors, and the possible re-emergence of a potential domestic investor with whom discussions had been previously held and reported to the Board; (3)

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	THE FIRST TWO WEEKS OF SEPTEMBER
		updates on other alternatives being considered in the event discussions with potential investors do not result in a transaction, including the exchange of outstanding convertible preferred stock for shares of common stock, a sale of 51% of the IMD, and other potential means to raise equity capital; and (4) Updates concerning a potential management change in Europe and the United States.
93	9/08/2008 05:34 PM	Draft A of Lehman’s 3Q 2008 Earnings Call Script notes that Lehman plans to spin-off commercial real estate with about \$33billion of debt financing provided by Lehman and plans to reduce residential real estate exposure. The draft also outlines separately the terms of an IPO for 20% stake in the IMD division and a 51% sale of the IMD division. The draft notes net losses of almost \$4 billion. The draft adds that Lehman’s “liquidity position, which remains very strong,” at \$42 billion - down from \$45 billion on May 31, 2008.
94	9/09/2008	Lehman executes the amendment to the Guaranty with Citigroup, adding LBI.
95	9/09/2008	Lehman pledges \$1 billion in cash and approximately \$1.7 billion of money market funds to Chase.
96	9/09/2008 07:30 AM	Lehman announced a third-quarter loss of \$3.9 billion along with its intention to sell 55 percent of its investment management division and to spin off \$25 billion to \$30 billion of its commercial real estate assets into a separate publicly traded company by the first quarter of 2009.
97	9/09/2008 12:00 PM	The Board of Directors’ minutes indicate that the Board, on the recommendation of the Finance and Risk Committee, agreed to pay an annual common stock dividend of \$0.05 per share, effective for dividends payable on or after September 2008. Board is updated on strategic initiatives, including: a spin-off of commercial real estate assets, a sale of 51% of the Lehman’s IMD, possible exchanges of outstanding convertible preferred stock for shares of common stock, and a possible capital raise with potential investors. Reference is made to discussions with two potential domestic partners, one of whom was concerned about the degree of overlap with its business and those of Lehman. Discussion of Lehman’s consideration of a pre-announcement of 3Q earnings and strategic initiatives as soon as possible, either that evening or the next day.
98	9/09/2008 05:37 PM	Citibank’s Polish branch delays payments related to foreign currency swaps between LBSF, LBCC, and counterparties. The delays result in late intercompany payments between the London desk and LBCC.
99	9/10/2008	Rating agencies, including Dominion Bond Rating Service (“DBRS”) and A.M. Best, downgrade their ratings for LBHI, and its related entities in light of Lehman’s 3Q announcement. While Standard & Poor’s, Moody’s, and Fitch do not lower their ratings, they place LBHI and its affiliates on “review.” These agencies note that they could lower their ratings if LBHI does not quickly reach an arrangement with another entity for either an acquisition or divestiture of its poorly performing assets. DBRS, S&P and Moody’s all view LBHI’s near-term liquidity as satisfactory.
100	9/10/2008	Lehman pledges an additional \$300 million in cash to Chase, totaling \$3 billion in two days.
101	9/10/2008	Press release announcing Lehman’s preliminary third quarter results and providing detailed financial information. The release notes an estimated net loss of \$3.9 billion, reduction in commercial and residential real estate exposures, the proposed spin-off of the commercial real estate division, and plans to sell a majority stake in IMD - albeit without naming a buyer. The release also evaluates results by business segment, showing an increase in losses in capital markets (to \$4.1 billion from \$2.4 billion in 2Q) and a decrease in revenue in investment banking (by \$300 million) and investment management (by \$.8 billion).
102	9/10/2008 05:22 AM	LBHI continues to experience problems with the willingness of counterparties to settle trades. Specifically, Chase did not roll \$385 million of commercial paper and cut LBI’s tri-party settlement line from \$2 billion to \$1 billion. Similarly, Citibank and Bank of America refused to allow trades in light of their exposures to Lehman. Other counterparties requested early terminations, upgraded trades, and increased haircuts.
103	9/10/2008 09:52 AM	Lehman experiences difficulties with Chase in calculating margin requirements. Lehman posts \$273.3 million with Chase to meet margin call.
104	9/10/2008 10:23 AM	Goldman Sachs informs Lehman that many of LBI’s Prime Broker clients transferred their accounts from LBI to Goldman Sachs.
105	9/10/2008 10:56 AM	Counterparties refusing to engage in foreign currency transactions with Lehman included: Mizuho Corp Bank, Calyon, ANZ, Westpac,

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

Date/Time		THE FIRST TWO WEEKS OF SEPTEMBER
		BNZ. Additional counterparties were “tight” on Lehman, including ING, BOA, Bank of Nova Scotia, State Street, Stanchart, HSBC, DBS, Chinatrust, Barclays. Lehman seeks to reduce risk by pricing in liquidity when quoting prices to clients.
106	9/10/2008 11:09 AM	Lehman continues to track a list of banks that took issue with Lehman’s financial condition, payments, and collateral. In its daily funding report, each bank or counterparty listed sought to restrict and/or restructure their credit and collateral arrangements, including HSBC (cut unsecured credit lines), Citibank (requested additional \$2 billion collateral and an additional \$1 billion that evening), DnB Bank in Norway (cut unsecured credit), and Standard Bank (requested and received \$200 million collateral against intraday exposure).
107	9/10/2008 03:37 PM	Lehman employees analyze the capital infusions received by LBI subsidiaries LCPI and LBSF. Over the last five years, LCPI received five capital infusions and LBSF received two. The total capital infusions were over \$2 billion for LCPI and \$300 million for LBSF.
108	9/11/2008	Lehman posts an additional \$600 million in cash to Chase and requests the return of \$500 million of corporate bonds that it had posted as collateral the night before. Chase releases a portion of the bonds to Lehman.
109	9/11/2008 10:00 AM	Reuters reported that Lehman Brothers shares fell as Wall Street questioned whether the investment bank will survive because of its failure to sell assets to cover losses from toxic real estate investments.
110	9/11/2008 11:00 AM	LBHI Board of Directors is updated concerning Lehman funding, and told that the Firm had funded that day and that the Firm believes that it has funding for the following day. It is stated that liquidity is forecasted to decrease to \$30 billion that day [9/12/08] as a result of providing collateral. Board is also updated on the discussion with Bank of America. The described goal is to announce a transaction Sunday night. It is reported that while Barclays had not directly reached out to Lehman, the Firm’s regulators had advised Fuld of their potential interest. Board is updated on discussions with J. Mack, Chairman and CEO for Morgan Stanley, regarding a potential transaction with Lehman, but Mack was concerned about the amount of overlap between the two organizations and the ability to announce a transaction by Sunday night. Further, Board discusses the potential situation if no transaction is completed over the weekend – the funding situation and the rating agency situation would be very difficult. The Board is advised that the Firm is working with the Federal Reserve and the SEC on an orderly liquidation of assets supported by credit from the Federal Reserve if a transaction does not occur.
111	9/11/2008 06:00 PM	JP Morgan Chase CEO, Jamie Dimon indicated to D. Fuld Thursday evening September 11, that Lehman needed to announce a sale transaction by market open Monday September 15 or Chase would immediately discontinue doing business with Lehman, effectively putting Lehman out of business. Based on discussions with Citi, Lehman believes Citi would take similar action.
112	9/12/2008	Lehman posts \$5 billion in cash in response to Chase’s 9/11/08 collateral request.
113	9/12/2008	SEC analyst notes that LBI’s liquidity pool is almost totally locked up with clearing banks to cover intraday credit at Chase and Citi.
114	9/12/2008	Bain Capital submits a proposal to acquire a 55% stake in IMD.
115	9/12/2008 01:07 PM	Keefe, Bruyette & Woods issues a memo discussing the impact of the S&P revising its “Creditwatch” for Lehman Brothers from “Negative” to “Developing.” On a conference call discussing Lehman, S&P analysts stated that “they do not expect Lehman to fail. They think counterparty and systemic risk in the market is ‘very very high’ because of the skittish market conditions and tight liquidity. However, they think that barring the problem assets owned by Lehman, the underlying business at the company is doing well and its near-term liquidity is satisfactory.”
116	9/12/2008 01:18 PM	Lehman sends unspecified recipients documents regarding the safety of customer assets, including an explanation of its 15c3-3 reserve account, oversight by the SEC and FINRA as it relates to this account, the procedures these regulatory bodies would undertake in the event Lehman suffered a deficiency in capital, and additional protection of client accounts afforded by SIPC.
117	9/12/2008 02:50 PM	Internal discussions concerning the interaction of potential simultaneous LBI, LBHI and LBSF defaults.
118	9/12/2008 04:00 PM	Board of Directors is updated on the Firm’s discussions with Bank of America and Barclays. Board is updated on the Firm’s discussions with the Federal Reserve and the Fed’s interest in helping to facilitate an orderly wind-down and avoid bankruptcy. Board is informed that management has consulted with bankruptcy counsel and introduced Weil Gotshal attorney H. Miller, who advised the Board that LBI would

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

Date/Time		THE FIRST TWO WEEKS OF SEPTEMBER
		not qualify for Chapter 11 under the Bankruptcy Code and would be subject to a SIPA proceeding.
119	9/12/2008 06:00 PM	FRBNY senior management summons a group of senior Wall Street executives to FRBNY to achieve an “industry” solution to Lehman’s problems. Talks continued through the weekend, but by Sunday afternoon both Bank of America and Barclays had bowed out, and word had circulated that Lehman was preparing to file for bankruptcy.
120	9/12/2008 06:01 PM	Lehman asks the FRBNY to pressure Chase to release \$5 billion in collateral in order for Lehman to pay the \$3.9 billion that they owe. Chase had previously represented that they would return this collateral to Lehman when trades settled.
121	9/12/2008 10:45 PM	Lehman begins preliminary planning for a wind-down plan based on assumption on that LBHI would file for Chapter 11 and that the firm would be liquidated.
122	9/13/2008	LBI and the CME discuss moving LBI’s futures accounts elsewhere in the event of a bankruptcy filing.
123	9/13/2008 09:00 AM	The Fed asks for meeting with Lehman to discuss plan for the “total Armageddon scenario.”
124	9/13/2008 10:10 AM	Goldman Sachs asks financial institutions to convene at the Fed for an urgent Operations Management Group OTC Derivatives meeting regarding Lehman. It further requests that anyone in the New York area attend the meeting in person.
125	9/13/2008 11:14 AM	Lehman is updated on the status of current bids for Lehman. Despite the number of parties initially approached, Bank of America and Barclays are the only two remaining parties.
126	9/13/2008 12:00 PM	LBHI Board of Directors is informed that there was no resolution yet with respect to Bank of America, but that it seemed to be a “game of chicken” between Bank of America, on the one hand, and the Federal Reserve and Treasury, on the other hand. Barclays was still pursuing a potential transaction, but noted that it would need shareholder approval of the transaction, would need to raise capital, and has much of the same types of assets as the Firm. Barclays’ positions that it would prefer not to assume Lehman’s commercial real estate assets. Board is updated on a meeting of financial institutions held the previous evening at the Federal Reserve in order to help facilitate a transaction between Lehman and Bank of America or Barclays, in turn finding a way to eliminate the need for federal money. Russo further reported that the Corporation had established a trust the previous day in order to fund employee health costs for a period of time in the event that Lehman makes a bankruptcy filing.
127	9/13/2008 02:05 PM	Lehman receives “block bids” from several banks to hire groups of employees from Lehman’s successful divisions, increasing pressure to finalize a transaction as soon as possible.
128	9/13/2008 05:00 PM	Board of Directors is informed about the potential structure for a transaction with Barclays, specifically that Barclays would purchase the operating subsidiaries of the Firm for \$3 billion and would guaranty the Firm’s debt. Lehman would receive the cash proceeds and also would retain the commercial real estate assets, the minority investments in hedge fund managers, and the limited partnership interests in the Firm-sponsored private equity funds. Under this proposed structure, a consortium of financial institutions would provide new debt financing to the Corporation (estimated at \$40 billion), with the preferred and common equity remaining in place at the Corporation. Board members expressed frustration about the Firm being “over a barrel” and concerns about obtaining the FSA’s approval on a timely basis.
129	9/13/2008 06:59 PM	Lehman prepares contingency liquidation plan showing how liquidation would proceed and describes the measures Lehman has in place to deal with this contingency. The presentation acknowledges that if there is funding uncertainty, LBHI would have to file for bankruptcy in a Chapter 11 proceeding, thereby making LBI subject to a SIPA proceeding and LBIE the subject of a receivership or administration. The presentation notes that both LBI and LBIE rely on funding from LBHI, which will not be able to fund either LBI or LBIE in their liquidations, thus the need for government or a third party financing arrangement.
130	9/14/2008	The FRBNY announces that it is expanding the categories of collateral accepted through the PDCF. While the FRBNY had previously accepted only investment-grade securities, it decides to accept any collateral that was acceptable for triparty repos. For LBI, the FRBNY limits the eligible collateral to that in LBI’s clearance box at Chase on 9/12/08. It also imposes larger haircuts on LBI than on other investment banks.

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	THE FIRST TWO WEEKS OF SEPTEMBER
131	9/14/2008	FRBNY will provide up to two weeks of overnight secured funding to allow LBI to accomplish an orderly liquidation.
132	9/14/2008 08:09 AM	LBHI makes a presentation regarding its commercial real estate and residential real estate portfolios to large banks, including Goldman, Credit Suisse, Citibank and others.
133	9/14/2008 11:53 AM	S&P warns it may lower Lehman’s credit rating absent announcement of a takeover agreement.
134	9/14/2008 01:05 PM	Lehman considers opening bank accounts out of LBI in ‘safe’ banks.
135	9/14/2008 1:05 PM	Lehman expresses concerns about the safety of LBI bank accounts and alternative banks into which to move funds out of LBI.
136	9/14/2008 01:16 PM	ISDA arranges for special unwind trading session for derivatives for 2-4 p.m. on Sept. 14.
137	9/14/2008 02:00 PM	Special unwinding trading session begins.
138	9/14/2008 02:50 PM	Lehman prepares two preliminary draft press releases describing the sale of LBHI to Barclays (“Brown Acquisition”) or Bank of America (“Blue Acquisition”). Both drafts omit key terms such as sale price and allocation of common stock, but include statements in support of the deal from Lehman executives B. McDade, F. Fuld, and the CEO of the acquiring company.
139	9/14/2008 04:00 PM	FSA informs FRBNY that the guaranty issue will need to be resolved before any take-over can be approved. FRBNY responds that it has arranged a consortium of Wall Street firms to take Lehman’s illiquid assets, but that a Barclays guarantee is still required. Eventually, FRBNY, Barclays, and the FSA discuss that the Barclays Board of Directors and FSA cannot approve any transaction requiring a Barclays guarantee.
140	9/14/2008 04:12 PM	LBI prepares a plan for delivering securities to the Fed pursuant to the PDCF. LBHI and LCPI would prepare a schedule of pledged assets and deliver those securities to the Fed, as an amendment to the current documents, through LBI “as Agent to the Fed for LBHI and LCPI.”
141	9/14/2008 4:20 PM	Reuters reported that the ISDA has extended the emergency trading session between Wall Street dealers with Lehman counterparty risk until 6 p.m. New York time.
142	9/14/2008 05:00 PM	Minutes of the LBHI Board of Directors indicate that the Board is updated on the status of discussions between the firm, the government, and potential investors or acquirers of the firm. Management had believed the Firm had reached a deal with Barclays, conditioned upon arranging third-party financing for the spin-off or sale of commercial real estate assets and approval by the U.K. Financial Services Authority. Discussions with Bank of America were not successful and that it appeared they were instead interested in acquiring Merrill Lynch. The Board is informed that the Firm had a liquidity problem, with much of the liquidity tied up at clearing banks, primarily Chase. He further reported the following: (1) the Federal Reserve Bank of New York (“FRBNY”) issued an emergency order allowing for non-investment grade securities to be used as collateral at the Fed window. While Lehman stressed the need for the FRBNY to accept a broader range of collateral, the Fed’s position was that the expanded window would only apply to tri-party repos of securities; (2) the Federal Reserve communicated to management that it preferred that LBI be wound down in an orderly fashion; (3) a failure to fund LBIE would obligate LBIE directors to initiate administration proceedings under U.K. insolvency laws, which in turn would trigger cross-defaults which represent a massive systematic risk that would potentially require the Corporation and certain subsidiaries to seek protection under Chapter 11; (4) the Firm has a bid for the IMD of the business that would raise cash and realize current value for a potential depreciation in the value of IMD; (5) the meeting of financial institutions assembled at the Federal Reserve had ended without an agreement to provide assistance to the Firm; and (6) the Corporation had hired bankruptcy counsel who were participating in discussions with the Fed.
143	9/14/2008 06:00 PM	Special Unwinding trading session ends.
144	9/14/2008 07:55 PM	Board of Directors is informed that the Fed had expressed its desire that the Board approve a Chapter 11 filing as soon as possible. It is also reported that LBI did not have the capacity to provide funding to LBIE which, in turn, would make it insolvent and require it to commence U.K. administration proceedings. The following key points were discussed: (1) the Firm’s derivatives would be in default once the corporation filed under Chapter 11; (2) the principal subsidiaries that are parties to derivatives rely on the Corporation’s guaranty for operations and the guaranty would probably eliminate the possibility of any shareholder recovery; and (3) debt holders, depending on their

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

Date/Time		THE FIRST TWO WEEKS OF SEPTEMBER
		place in the structure, may not be paid. B. McDade and others at Weil joined the meeting after returning from the meeting at the Federal Reserve and reported on their discussions which pertained to the following matters: (a) the filing of bankruptcy; (b) the Fed’s provision of an unwind for the Firm’s tri-party agreements, the Fed agreement to take out counterparties against qualified collateral; (c) the need to operate LBI, in respect of which the Fed will provide funding for one month of up to \$500 million against qualified collateral; (d) the Fed’s desire that the Firm find a DIP lender for the U.S. broker-dealer; (e) market impact; and (f) the Fed’s direct and authoritative statements it wanted the Corporation to file under Chapter 11 that evening. Chase is holding approximately \$17 billion of collateral and is demanding another \$5 billion. C. Cox, Chairman of the SEC, and T. Baxter, General Counsel of the New York Federal Reserve along with their counsel, Cleary Gottlieb, joined the meeting by conference call and in response to the Board’s discussions regarding the necessity and implications of a bankruptcy filing. The SEC and Fed representatives emphasized that it was the Board’s decision, but the decision to file bankruptcy had to be made quickly because of its impact on the financial markets. LBHI Board authorized the filing of bankruptcy under Chapter 11 of the Bankruptcy Code.
145	9/14/2008 10:00 PM	B. McDade and R. Diamond (Barclays) discuss whether Barclays is interested in only purchasing LBI. Shortly after this discussion, Diamond informs McDade that Barclays is interested in the transaction.
146	9/14/2008 11:47 PM	LBHI establishes payment release criteria in advance of filing for bankruptcy. Payments from LBI, NB, LBB, LBCB, LOTC and LBCC FX activity can be released. However, these payments can “only be made to each other and out to the street. Payments with any other Lehman entities as beneficiaries must be blocked.”

Date/Time		LBI’S LAST DAYS
147	9/15/2008	The CME receives bids for LBI’s proprietary positions with the CME.
148	9/15/2008	The CME places LBI on “liquidation only” status for its proprietary positions, and gives the CME Clearing House Division authority to sell or transfer LBI’s house positions in bulk. LBI does not liquidate its positions, but instead modestly adds to its positions over the next two days.
149	9/15/2008	Citibank sends letters to Lehman’s CLS user members (LBI, LBCC, LBSF, and LBIE) advising them that they are terminating the CLS Settlement Services Amended and Restated Agreement. Agreement is signed requiring Lehman to deposit \$1 billion in an account with Citibank in order for Citi to maintain CLS services for LBI and LBCC on 9/16/08.
150	9/15/2008	Citibank sends a letter suspending the earlier termination notice for one day.
151	9/15/2008	LBI borrows \$28 billion from FRBNY via the PDCF. The FRBNY also advances \$18.5 billion to LBI under the TSLF and \$2.8 billion in OMO.
152	9/15/2008	LBI personnel begin setting up an auction for LBI’s CME positions to be held on 9/16/08 or 9/17/08.
153	9/15/2008 12:39 AM	Lehman restricts access to the INFINITY operating system to permit trading activities against only LBI. INFINITY is part of the MTS system relating to futures transactions. Access to all other Lehman entities is blocked.
154	9/15/2008 01:45 AM	LBHI Chapter 11 Filing. LBHI’s Form 8-K reports the September 15, 2008 filing of a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the Bankruptcy Code) in the United States Bankruptcy Court for the Southern District of New York and on September 16, 2008, LB 745 LLC filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. LBHI will continue to operate its business as a debtor-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and the orders of the Court. In addition, the Directors of certain affiliates of LBHI in the United Kingdom, including Lehman Brothers International (Europe), Lehman Brothers Holdings Plc, Lehman Brothers Limited and LB UK RE Holdings Limited, have concluded that in the absence of ongoing financial support from LBHI, they are or are likely to become unable to pay their debts as they fall due. Accordingly, these companies have been placed into administration.

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	LBI’S LAST DAYS
155	9/15/2008 08:03 AM	DTCC sends a memo to its member banks informing them that DTCC will continue to act for LBI, LBB and Newberger Burman. The DTCC further states that despite LBHI’s bankruptcy filing, these LBI entities are still in full compliance with their DTC participation requirements.
156	9/15/2008 08:03 AM	NSCC sends a memo to its member banks informing them that the NSCC will continue to act for LBI and Newberger Burman. The NSCC further states that despite LBHI’s bankruptcy filing, these LBI entities are still in full compliance with their NSCC participation requirements. The memo emphasizes that all transactions with LBI remain fully guaranteed for their settlement.
157	9/15/2008 08:06 AM	Internal discussions regarding the trading impact of LBHI’s bankruptcy and LBIE’s administration. As a result of these proceedings, all cash flows out of and between Lehman entities are frozen.
158	9/15/2008 11:25 AM	Chase and Citibank resign as LBI’s clearing banks, thereby preventing money from coming into LBI and making it increasingly difficult for LBI to effect an orderly unwind and avoid SIPA liquidation. There is some question as to whether Citibank and Chase must provide LBI 30 days notice of their resignations.
159	9/15/2008 12:51 PM	RBC informs LBI that all trades are on hold until further notice.
160	9/15/2008 01:24 PM	LBI authorizes the entry of CLS trades that will settle currencies, thus avoiding a major cause of defaults.
161	9/15/2008 04:03 PM	LBI informs Chase that it is moving \$700 million to an LBI account at Citibank.
162	9/15/2008 04:46 PM	DTCC announces that LBIE has been placed into administration in the UK. As a result, all new activity submitted against LBIE is being held in a special queue at Deriv/SERV and will be processed one per day in a special overnight cycle.
163	9/15/2008 04:58 PM	LBI discusses its inability to perform any manner of Global FX trading for LBIE and LBSF. Therefore, LBI makes the decision that there should be no settlement in or out of LBIE and LBSF until the administrators say differently.
164	9/15/2008 07:29 PM	Clearing broker BMO Nesbitt Burns Ltd. informs the Montreal Exchange clearing house, the Canadian Derivatives Clearing Corporation, that they would no longer accept opening of positions in LBI accounts. As a result, LBI can no longer open any positions for derivatives instruments listed in the Montreal Exchange. LBI is still able to execute transactions to close out current positions or to transfer such positions to another firm.
165	9/15/2008 08:14 PM	The SEC tells LBI that it must increase its reserve deposit by 9/16/08 to cover any shortfall resulting from LBI’s erroneous withdrawal of \$1.1 billion from LBI’s reserve account. The SEC “did not authorize the withdrawal,” therefore, “the firm will need to increase the reserve deposit tomorrow morning by any shortfall.”
166	9/15/2008 11:06 PM	LBI’s final cash position on 9/15/08: short approx \$2.1 billion with around \$2.3 billion of US f/x fails to receive and \$1.5 billion of fails to pay for margin, overdrawn at Citi \$3 billion US and long approx \$900 million in currency, and net down \$2.1 billion. LBI had to give Citi an extra \$1 billion so they would continue to settle CLS.
167	9/16/2008	LBI wires \$2.5 billion to its IMD clients relating to customers’ sales of many market funds and securities. In some cases where the transfer related to the customer’s sale of a money market fund, LBI would wire out the cash to the customer, but not receive the cash in from the money market fund until the next day, creating a cash shortfall.
168	9/16/2008	LBI pledges \$23 billion of collateral to the PDCF in exchange for \$19.7 billion in cash.
169	9/16/2008	FRBNY requests that Barclays “step into the shoes” of the FRBNY with respect to overnight financing of LBI to facilitate an orderly transition of the broker-dealer assets to Barclays.
170	9/16/2008 12:27 AM	Lehman plans to sell its IMD assets. LBHI will need bankruptcy court approval for the sale.
171	9/16/2008 06:00 AM	Minutes of the Board of Directors indicate that the Board meeting included both LBHI and LBI Directors because there was a sale consideration for both parties. Discussion of details to be resolved on the sale transaction, but LBHI is hoping to be able to announce the deal before the U.S. markets open. The transaction with Barclays is described as consisting of the following: (1) the purchase of 745 Seventh Avenue for approximately \$1 billion; (2) debtor-in-possession (“DIP”) financing of \$500 million for LBHI, half in the form of a

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	LBI’S LAST DAYS
		term facility and half in the form of a revolving facility; and (3) the transfer of most assets of the U.S. broker-dealer, along with approximately 10,000 employees, to Barclays.
172	9/16/2008 12:41 PM	The CLS intraday trading through Citibank for 9/17/08 “is huge (peaking around \$8 billion around 6am).” As a result, Citibank is seeking full collateralization of this amount, which LBI is not able to provide. Therefore, LBI will need to settle those trades bilaterally. LBI asks Citibank to provide LBI with the details of the largest trades that are causing these problems.
173	9/16/2008 03:11 PM	LBIE receives permission from the administrator, PwC, to close out LBIE trades to the street (as opposed to intra-company trades).
174	9/17/2008	After it becomes apparent that Barclays would not assume the risk for LBI’s proprietary positions, that LBI would make a bankruptcy court filing on 09/19/08, and that the Australian exchange was preparing to suspend Lehman’s trading, the CME decides to re-solicit bids for the purchase of LBI’s house portfolio and to transfer the positions to the winning bidders on 9/18/08.
175	9/17/2008	LBI pledges \$23.3 billion in collateral to the PDCF in exchange for \$20.4 billion in cash.
176	9/17/2008	The CME authorizes an auction to take place on 9/18/08 to liquidate Lehman’s house portfolio.
177	9/17/2008	Barclays agrees to take the FRBNY’s place in providing overnight funding to LBI.
178	9/17/2008	Lehman seeks CFTC oversight of its plan to auction its CME portfolio, citing concern about potential market manipulation.
179	9/17/2008 06:26 AM	LBI seeks an indemnification letter from Barclays to prevent a number of buyins from occurring on 9/17/08 and 9/18/08.
180	9/17/2008 07:00 AM	During a Barclays conference call announcing its agreement to acquire Lehman assets, B. Diamond (Barclays) states that the opportunity to purchase Lehman has been around for many months and they were just waiting for the deal to be right. Because the deal occurred through bankruptcy, Barclays “got to choose which inventory came with the deal, and primarily [] chose things that were important to the underlying business.” A Barclays executive states that the transaction is a good deal “because we’ve not taken the entire balance sheet that created that income. What we’ve taken is a portfolio of trading assets and liabilities that are, first of all, de-risked, and secondly, those that need to support the ongoing parts of the business that we have acquired.”
181	9/17/2008 10:20 AM	LBI cash has declined by \$2 billion in the last two days.
182	9/17/2008 11:56 AM	To facilitate an orderly unwind, LBHI plans to seek an exemption from the buy-in requirements for its clients until LBIE’s administrator releases the frozen securities.
183	9/17/2008 12:13 PM	Internal discussions concerning why customer withdrawals are impacting LBI’s broker-dealer cash account. LBI wires cash to a customer when the customer sells a security. If LBI does not properly credit the sale of the securities, this could impact LBI’s broker-dealer cash account.
184	9/17/2008 04:07 PM	In spite of earlier refusals to do so, LBHI determines that LB I Group needs to be moved out of LBI. LBHI then considers whether other LBI subsidiaries should be moved.
185	9/17/2008 04:31 PM	LBF continues to struggle with access to funds in its Citibank account and threatens legal action against LBI.
186	9/17/2008 05:05 PM	OCC risk director and general counsel tells LBI that LBI needs a new settlement bank. If LBI does not make a payment due to the OCC by 9AM on 9/18/08, the OCC “could potentially shut down all our OCC positions.”
187	9/17/2008 10:02 PM	Internal discussions regarding concerns about ability to fund LBI’s operations for 9/18/08.
188	9/17/2008 10:02 PM	LBF seeks to retrieve approximately \$12 million locked up in its Citibank account needed for LBF’s payroll.
189	9/18/2008	The CME transfers LBI’s house positions (including LBHI affiliate positions cleared through LBI).
190	9/18/2008	Chase advances \$46.22 billion in cash to the FRBNY to unwind the FRBNY’s financing of LBI. LBI’s collateral with the FRBNY is delivered to LBI’s clearance box at Chase.
191	9/18/2008	Barclays and LBI enter into a repo transaction under which Barclays is to send \$45 billion in cash to Chase for the benefit of LBI, and LBI would pledge securities in excess of that amount to Barclays.

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	LBI’S LAST DAYS
192	9/18/2008	The CME provides notice to the CFTC that it took emergency action with respect to LBI on 9/17/08. The notice states that the President of the Clearing House “determined that an emergency action was necessary given the financial condition of [LBI] and to ensure the orderly functioning of the market,” and that the Clearing House should immediately conduct an auction to secure bidders to purchase LBI’s house account positions.”
193	9/18/2008	Barclays begins the process of transferring \$45 billion in cash to LBI in order to fund LBI overnight. DTCC and the Fedwire Securities Service remain open for several hours past their closing times in an effort to complete the intended transfer of collateral from LBI to Barclays. Not all collateral is successfully transferred, however.
194	9/18/2008 12:24 AM	The CME Group says it is “very dissatisfied with the conduct” of LBI. According to the CME, LBI did not comply with CME’s instructions to trade only to reduce risk and to liquidate its portfolio. LBI only liquidated its natural gas portfolio, which was just for the value of the original margin. The CME is specifically concerned because there are deliveries due of treasuries on Friday, but LBI is not in a position to buy treasuries. Therefore, the CME intends to direct an auction of all LBI positions starting the next morning. The CME will include Barclays as a possible bidder.
195	9/18/2008 05:07 AM	Bank Leumi files an action against LB Israel, a subsidiary of LBI, and LBIE because a \$100 million wire from LBIE to Bank Leumi did not reach Bank Leumi. Bank Leumi also asserted a lien against LB Israel.
196	9/18/2008 10:14 AM	The transaction with Barclays will not include any of LBI’s subsidiaries. Instead, plan is formulated whereby LBI will transfer ownership of equity in the subsidiaries to LBHI or a wholly owned subsidiary in exchange for a note with a value equal to the fair value of these assets.
197	9/18/2008 10:53 AM	Intercompany repo trades face LBI from LCPI, LCHI, Bankhaus, and LBIE. LBI had \$4.67 billion in reverse repo (with cash into LCPI) in exchange for \$5 billion in RACERS. In total, intercompany trades facing LBI would result in a cash outflow of \$5.3 billion. The amount does not include trades with LBIE.
198	9/18/2008 AM	The CME completes liquidation of all LBI house positions.
199	9/18/2008 11:37 AM	LBI reports that the value of its 15c3-3 account was down ~\$2.2 billion on 9/17/08. LBI used securities that it received after the Fed cutoff for PDCF as part of JPMC “box loan.”
200	9/18/2008 12:15 PM	FINRA requests that LBI provide additional information concerning withdrawal of \$2 billion from its customer reserve account. FINRA strongly suggests that “the firm does not allow this Account to be Under Funded for any length of time throughout today with such a large withdrawal that took place last night.” FINRA also requests information about where LBI holds securities in custody for customers both domestically and internationally, asking for information about positions and market value.
201	9/18/2008 12:42 PM	LBI investigates why it appears to be losing \$300 million in cash with respect to intercompany repo trading with LBSF.
202	9/18/2008 12:51 PM	LBI hears rumors that the exchanges are closing out all LBI house positions today. Therefore, LBI instructs its employees to stay in contact with the exchanges throughout the day and for all excess margin positions to be redeemed with cash wired back today.
203	9/18/2008 01:41 PM	The Intercontinental Exchange Clear US (“ICE”) Board of Directors orders the immediate liquidation of LBI’s proprietary positions carried out at the ICE.
204	9/18/2008 02:11 PM	LBI is unable to fund \$298 million to GSSC and \$240 million to NSCC. The wires were supposed to go out from Chase’s main cash account, which is now devoid of funds.
205	9/18/2008 02:34 PM	Citibank agrees to make payments to allow LBI to fund \$298 million to GSSC and \$240 million to NSCC.
206	9/18/2008 04:33 PM	FINRA requests information regarding the cash side of LBI’s 15c3-3 account after Lehman withdrew \$225 million earlier in the day. According to FINRA, the P.A.I.B. is currently under funded by ~ \$11 million.

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	LBI’S LAST DAYS
207	9/18/2008 04:38 PM	Fails in MTS total in the billions of dollars.
208	9/18/2008 05:34 PM	The ICE Clear USA orders LBI not to liquidate any new trades that remain open tomorrow.
209	9/18/2008 05:47 PM	FINRA expresses concerns with the amount that LBI has put into its 15c3-3 account to replace the \$2 billion it withdrew.
210	9/18/2008 06:01 PM	Barclays refuses to take the liabilities resulting from any customer fails. In response, LBHI wants to move and settle the trades instead of leaving them with LBI.
211	9/18/2008 09:25 PM	The OCC is not releasing LBI client collateral despite LBI meeting its payment obligations via a direct fed funds wire earlier in the morning.
212	9/18/2008 09:31 PM	Nasdaq makes a decision to restrict LBI’s access to the Nasdaq and the TRF (ACT) beginning on 9/19/08. Nasdaq makes this decision because it received a call from the DTCC informing it that Barclays would not be accepting any open positions.
213	9/18/2008 09:43 PM	Chase requests clear instructions from Barclays and SIPC on how to deal with LBI assets that it receives in LBI operating accounts at Chase. On 9/19/08, Chase will continue to provide access to LBI’s operating accounts, but “will minimize its risk to overdrafts by requiring that adequate cash be available in an Operating Account before payment and other transfers are made therefrom.” After the deal with Barclays closes, Chase will need instructions on handling property it receives into LBI’s accounts to identify whether it is receiving LBI or Barclays property. Chase also will require satisfactory protection from SIPC and/or Barclays to assure that JPMorgan will be repaid promptly for any overdrafts or liabilities arising from the Operating Accounts during this period. JPMorgan has requested that Barclays provide a guaranty of such overdrafts and liabilities, and to date Barclays has not agreed to provide a guaranty...
214	9/18/2008 10:37 PM	LBI cannot perform any trading on 9/19/08, but can accept wires and checks because its trading box #074 has been deactivated.
215	9/18/2008 10:39 PM	DTCC sends LBI a Draft FICC notice, scheduled to go in effect 9/19/08, announcing that FICC has suspended all LBI trade input and intends to settle LBI transactions because LBI is being placed into SIPA liquidation.
216	9/18/2008 11:27 PM	LBI expresses concern about its ability to transfer positions to Barclays without also transferring the fails.
217	9/19/2008	Chase freezes LBI’s clearing accounts and prevents LBI from accessing Chase’s dealer securities trading systems because of overdrafts in LBI’s accounts. Until this issue is resolved, LBI is unable to access its clearing accounts at Chase, or to settle outstanding trades and collateral movements. This eliminates LBI’s visibility in Chase’s BDAS system used by LBI, and prevents LBI from reconciling trades and bank accounts.
218	9/19/2008	LBI agrees to transfer \$7 billion cash to a Barclays account held at Chase. This transfer does not occur because the SIPA proceeding is initiated. The \$7 billion cash that was initially scheduled to be transferred from LBI to Barclays is instead, transferred to an LBI account held at Chase.
219	9/19/2008 12:11 AM	Nasdaq decides to restrict LBI’s access to Nasdaq and the TRF (ACT) because of a phone call it received from DTCC expressing concern about LBI’s trades not being guaranteed. DTCC’s concern is based on incorrect information provided by someone at Barclays. To resolve the situation quickly, DTCC’s counsel asks for an authoritative written statement from Barclays that it will unconditionally assume all open LBI trades and obligations at the clearing corporations.
220	9/19/2008 12:43 AM	Barclays prepares a press release stating that it has agreed to assume all open LBI trades and obligations at the clearing corporations in order to get the situation with Nasdaq restricting LBHI’s access resolved.
221	9/19/2008 01:29 AM	Counsel for Barclays informs the DTCC that assuming the Barclays/LBHI deal goes through, it is prepared to guaranty LBI’s open trades in Box 074 in “an aggregate net amount not to exceed \$250 million” and “[t]his agreement is conditioned upon a modification to the Asset Purchase Agreement permitting Barclays Capital Inc. to hold back from the purchase price an amount equal to the amount guaranteed.”
222	9/19/2008 05:53 AM	Resolution of the Board of Managers of Neuberger Berman authorizing the Assignment and Assumption Agreement between Neuberger Berman and LBI.
223	9/19/2008 07:11 AM	Nasdaq issues a notice of access restriction stating that LBI is restricted from Nasdaq access effective immediately. Nasdaq explains that

Trustee's Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

Date/Time		LBI'S LAST DAYS
		this action is based on absence of a guarantee of LBI's trades.
224	9/19/2008 08:02 AM	SIPC issues a statement that it "will file a proceeding placing LBI in liquidation under the Securities Investor Protection Act (SIPA)." SIPC's action is being taken in connection with the proposed sale of the business to Barclays. "A hearing on approval of that sale is scheduled for September 19, 2008, at 4 p.m., in the Chapter 11 proceeding of the parent company, LBHI."
225	9/19/2008 08:05 AM	Lehman discusses Barclays' guarantee of LBI's DTC fails up to \$250 million. As a result of the failure to reach an agreement on the guarantee, DTCC and FICC are threatening not to clear LBI trades.
226	9/19/2008 09:56 AM	LBI is authorized to do risk reducing trades or trades that bring cash into the firm, but no cash is to go out. Lehman states that all trading must be approved by appropriate management.
227	9/19/2008 10:30 AM	At a meeting of LBI's Board of Directors, also attended by Alvarez and Marsal, and outside counsel Dechert and Weil Gotshal, Board consents to SIPC's initiation of the LBI SIPA Proceeding and entry of the protective decree. The LBI Board also approved the transfer to Lehman ALI of certain of LBI's interests in its first tier subsidiaries and intellectual property, in exchange for the PIK Notes.
228	9/19/2008 11:12 AM	FINRA requests the collateral reports for both securities and cash held at Chase, Wells Fargo and HSBC after LBI withdrew \$1 billion from its 15c3-3 account. FINRA also renews its request for the information with respect to LBI's \$225 million withdrawal on 9/18/08.
229	9/19/2008 11:12 AM	FINRA struggles to track Lehman's collateral accounts at several banks on 9/19/08, as well as where LBI held securities in custody for customers - domestically and internationally.
230	9/19/2008 11:31 AM	LBI tries to resolve an overdraft issue with Chase that has culminated in Chase's freezing of LBI accounts. LBI cannot clear or settle any transactions with clients or provide Barclays with additional collateral.
231	9/19/2008 11:38 AM	Drafting of the first amendment to the APA. Correspondence between counsel for the various parties indicates that time is of the essence to get the draft done "to avoid assets going into the SIPC proceeding."

Date/Time		THE SIPA LIQUIDATION
232	9/19/2008 01:29 PM	Filing by SIPC of SIPA liquidation complaint against LBI in SDNY and entry by District Court of order commencing liquidation, <i>inter alia</i> appointing the Trustee, authorizing him to take possession of property and information, and staying certain actions.
233	9/19/2008 03:05 PM	LBI requests that the CME release its house excess and additional currency balances of about \$8,000,000.
234	9/19/2008 03:18 PM	A director of Lehman Brothers ALI, Inc., refuses to sign a consent of the Lehman ALI Board of Directors regarding the transfer of LB I Group, out of LBI and into ALI. Director is only willing to consent if the bankruptcy counsel is able to "get everyone protection."
235	9/19/2008 04:36 PM	Sale hearing on the approval of the broker-dealer sale to Barclays begins in United States Bankruptcy Court SDNY
236	9/19/2008 05:01 PM	The OCC advises LBI, while the Trustee and his counsel are in court, that despite LBI meeting its obligations, the OCC has locked up LBI account due to a policy decision.
237	9/19/2008 05:21 PM	Barclays decides not to purchase all of Lehman's foreign currency business.
238	9/19/2008 05:56 PM	LBI and Barclays experience difficulty verifying trade risk as positions were being transferred from LBI to Barclays.
239	9/19/2008 07:19 PM	LBI works with the SEC and SIPC to require Chase to release funds to permit the Neuberger Berman client conversion.
240	9/20/2008 04:10 PM	Chase informs the Trustee that it must lock down LBI's Chase accounts against all automatic deposits and withdrawals because Barclays does not intend to purchase any securities held by Chase in LBI accounts and that LBI does not intend to assume any of Chase's OTC contracts with LBI (FX, securities lending, etc.). Chase will lock down LBI's accounts as collateral for LBI's obligations to Chase with respect to substantial overdrafts, OTC contract terminations, and other liabilities. Chase deems the lock-down "necessary to prevent commingling or loss of the collateral and the potential for additional overdrafts."

Trustee’s Preliminary Investigation Report And Recommendations
Chronology -- 1987 to September 22, 2008

	Date/Time	THE SIPA LIQUIDATION
241	9/20/2008 05:00 PM	Internally, LBI cannot discern which accounts <u>have</u> actually settled versus what <u>may</u> have settled because Chase still may have been making some settlements even after it decided to lock LBI out on 9/19/08. Some accounts may need additional funding to settle.
242	9/20/2008 07:11 PM	Barclays management tells Lehman employees that it extends offers to join Barclays to all active Lehman employees in Fixed Income and Equities Sales, Trading and Research, Prime Services, Investment Banking, Principal Investing and Private Investment Management in North America, Argentina, and Uruguay, as well as Corporate support staff for those businesses. Barclays management also discloses that the majority of Lehman senior management has agreed to join Barclays.
243	9/20/2008 11:10 PM	LBI determines that the number of stock record breaks in the 15c3-3 reserve account is “overwhelming.”
244	9/21/2008 09:43 AM	LBIE threatens to cut off services to other Lehman entities as of 9/22/08.
245	9/21/2008 12:23 PM	Lehman disables its access to the Faster Payments Service (UK bank transfer method) with Chase in light of the assignment to Barclays, but Lehman does not disable the link to Citibank.
246	9/22/2008	The Barclays Sale Transaction closes.
247	9/22/2008	The OCC, the SIPA Trustee, and Barclays execute the Transfer and Assumption Agreement.

EXHIBIT D

Trustee Recommendation: A Required Liquidation Plan

A pre-existing liquidation plan could help avoid rushed last-minute planning and provide essential details for an efficient liquidation¹

- Address range of possibilities from complete liquidation of customer accounts to total or partial account transfers
- Provide details of key operational steps and core assets that would have to remain to assure effective liquidation of customer accounts
- State conditions to which a potential partial acquirer would have to be prepared to agree
- Include “Living Will” (*see next page*)
- Maintain and update plan, by regulation or statute

1. For more on this and related issues, see Section IX: Recommendations for Future Liquidations with Customer Implications, Whether Under SIPA or Another Orderly Liquidation Authority.

Trustee Recommendation: A Required Liquidation Plan (continued)

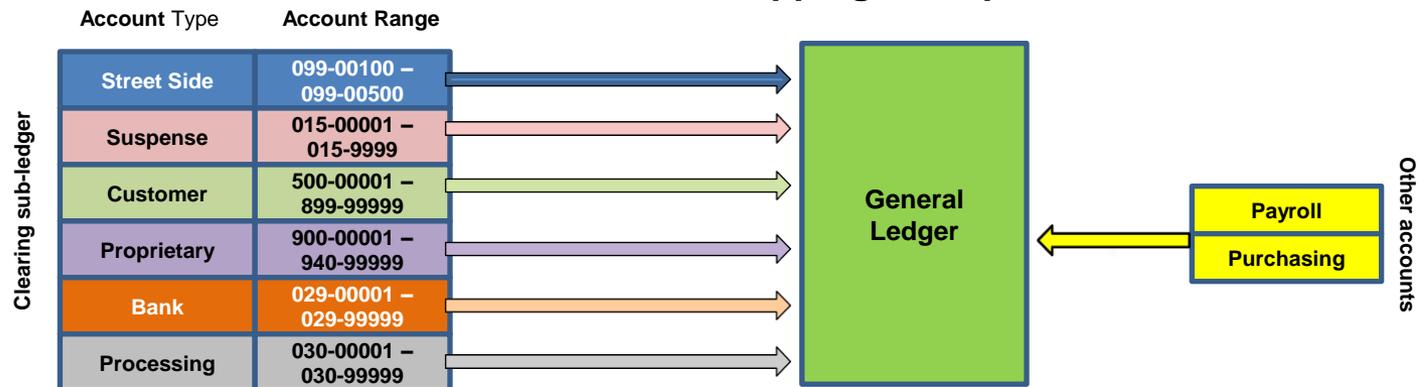
A “Living Will” would require key information and documents to be maintained and updated on a regular basis

- Schedule of key systems and information sources and related technical support; assurance of continuing access
- Identification of key human resources; assurance of continuing access
 - Back office operations (e.g. settlement and clearance, corporate actions)
 - IT
 - Finance
 - Tax
 - Legal / Regulatory compliance
- Index of key contracts and lists of clearing banks, bank deposits, depositories, major repo and stock loan / stock borrow counterparties
- Explanation of chart of accounts, account holder agreements, applicable systems, box locations and associated collateral

Trustee Recommendation: A Required Liquidation Plan (continued)

- ❑ Sample explanatory chart of accounts and associated general ledger
- ❑ Depending on the size and structure of the firm, the general ledger may be a separate system from clearing system. Account ranges typically include:
 - ❑ Clearing sub-ledger accounts:
 - ❑ Street Side Accounts – depositories and clearing banks where positions are maintained (e.g. DTCC, Euroclear)
 - ❑ Suspense Accounts – accounts holding funds and/or positions for which the account holder is not known
 - ❑ Customer Accounts – accounts which house customer positions and money (e.g. retail or institutional)
 - ❑ Proprietary Accounts – accounts which house firm proprietary positions and money
 - ❑ Bank Accounts – accounts where the firm has accounts
 - ❑ Processing Accounts – accounts used for the purpose of processing corporate actions related to security positions
 - ❑ Other firm accounts:
 - ❑ Payroll
 - ❑ Purchasing accounts payables and receivables (e.g. supplies)

Chart of Accounts – Mapping Example



Trustee Recommendation: A Required Liquidation Plan (continued)

- Schedule of vendor relationships and contracts
 - Transactional (e.g., SWIFT)
 - Pricing – external sources supplying pricing data to price and value security assets
 - Mailing services – external sources used for customer mailings (e.g. proxy, corporate actions)
 - Books and records
 - Recordkeeping (e.g., Broadridge)
 - Electronic archives and data warehouses (e.g., Iron Mountain)
 - Software providers and licensors
 - Mainframe and system providers and licensors
 - Operational support
 - Clearing services
 - Document management
 - Securities transaction processing
 - Data hosting and warehousing
 - Portfolio management

- Comprehensive files in single location for key documents including “no lien” letters, affiliate agreements, and subordination agreements

- Index and explanations of historic filings (e.g., SIPC 17 report)

EXHIBIT E

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re

LEHMAN BROTHERS INC.,

Debtor.

Case No. 08-01420 (JMP) SIPA

**ORDER, PURSUANT TO SECTION 105(a) OF THE
BANKRUPTCY CODE, APPROVING AND AUTHORIZING
PROCEDURES TO UNWIND, CLOSE-OUT AND REDUCE TO
CASH RECEIVABLES OWED BY TRADING COUNTERPARTIES**

Upon the motion dated October 29, 2009 (the “Motion”)¹ of James W. Giddens (the “Trustee”), as Trustee for the SIPA liquidation of the business of Lehman Brothers Inc. (the “Debtor” or “LBI”), seeking entry of an order, pursuant to section 105(a) of title 11, United States Code (the “Bankruptcy Code”), approving and authorizing procedures for the unwind, close-out and reducing to cash of Receivables owed by LBI Counterparties, as more fully set forth in the Motion; and this Court having jurisdiction to consider the Motion and the relief requested therein in accordance with 28 U.S.C. §§ 157 and 1334; and consideration of the Motion and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided, and it appearing that no other or further notice need be provided; and the relief requested in the Motion is appropriate and in the best interests of the LBI Estate, its customers, its creditors, and all parties in interest; and the Court having

1. Capitalized terms not defined herein shall have the meaning ascribed to them in the Motion.

reviewed the Motion; and the Court having determined that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, it is

ORDERED that the Motion is granted; and it is further

ORDERED that the following procedures are hereby approved and established:

- With respect to any Receivable, the Trustee is authorized and has the full power and authority to resolve, fix and reduce to cash amounts owed by an LBI Counterparty to the LBI Estate (the “Payment Amount”), and the Payment Amount may incorporate setoffs solely to the extent that such setoff is permitted by applicable law.
 - With respect to Payment Amounts below \$3,000,000.00, the Trustee may resolve and reduce to cash the Receivables without further Court order. The Trustee’s interim reports to the Court, as required by section 78fff-1(c) of SIPA, and order of this Court dated November 7, 2008 (Docket No. 241), will include information regarding those Receivables collected by the LBI Estate in the period covered by such report.
 - With respect to Payment Amounts of \$3,000,000.00 and above, the Trustee will henceforth prepare a stipulation and order (a “Court Stipulation”) and seek Court approval by Notice of Presentment, in accordance with the Case Management Order entered in this proceeding (Docket No. 240).
- A Court Stipulation may address and permit the collateral, margin, securities or other property held by the LBI Counterparties or by the LBI Estate to be liquidated, returned or setoff with respect to any Receivable.
- With respect to any Receivable, the Trustee is authorized, but not required, to provide a release to the LBI Counterparties to the extent that the Trustee determines that a release is appropriate.

; and it is further

ORDERED that nothing in the Motion shall be deemed to be an admission of fact by the Debtor or Trustee, for any purposes whatsoever, concerning the Receivables or the purported resolution of any of the Receivables; and it is further

ORDERED that the Trustee is hereby authorized to execute and deliver all instruments and documents, and take such other actions, as may be necessary or appropriate to implement and effectuate consensual resolutions pursuant to the procedures set forth in this Order; and it is further

ORDERED that entry of this Order is without prejudice to the rights of the Trustee, including, but not limited to, the right to seek further, other, or different relief regarding the Receivables pursuant to, among other things, section 365 of the Bankruptcy Code; and it is further

ORDERED that notice of the Motion as provided therein is deemed to be good and sufficient notice of such Motion and the requirements of Bankruptcy Rules 6006(a) and 9014 are satisfied; and it is further

ORDERED that this Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation and/or interpretation of this Order and/or the terms of any agreement consummated pursuant to the procedures set forth in this Order; and it is further

ORDERED that all objections to the Motion or the relief requested therein that have not been withdrawn, waived, or settled, and all reservations of rights included therein, are overruled on the merits; and it is further

ORDERED that any stay of this Order provided by the Bankruptcy Rules (including Bankruptcy Rule 6004) whether for ten (10) days or otherwise shall not be applicable

to this Order, and this Order shall be effective and enforceable immediately upon entry.

Dated: New York, New York
November 19, 2009

s/ James M. Peck
Honorable James M. Peck
United States Bankruptcy Judge