SECURITIES AND EXCHANGE COMMISSION

# FORM 10-K

Annual report pursuant to section 13 and 15(d)

Filing Date: **2004-02-26** | Period of Report: **2003-11-30**
**SEC Accession No.** 0001047469-04-005692

(HTML Version on secdatabase.com)

## FILER

**LEHMAN BROTHERS HOLDINGS INC**

CIK:**806085**| IRS No.: **133216325** | State of Incorp.:**DE** | Fiscal Year End: **1130**
Type: **10-K** | Act: **34** | File No.: **001-09466** | Film No.: **04629660**
SIC: **6211** Security brokers, dealers & flotation companies

Mailing Address
*LEHMAN BROTHERS*
*745 SEVENTH AVENUE*
*NEW YORK NY 10019*

Business Address
*LEHMAN BROTHERS*
*745 SEVENTH AVENUE*
*NEW YORK NY 10019*
*2125267000*

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

---

# Form 10-K

**(Mark One)**

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended November 30, 2003**

**OR**

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to**

**Commission File Number 1-9466**

---

# Lehman Brothers Holdings Inc.

(Exact Name of Registrant as Specified in its Charter)

| **Delaware** | **13-3216325** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **745 Seventh Avenue New York, New York** | **10019** |
| (Address of principal executive offices) | (Zip Code) |

Registrant' s telephone number, including area code: **(212) 526-7000**

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, $.10 par value | New York Stock Exchange<br>Pacific Exchange |
| Depositary Shares representing 5.94% Cumulative Preferred Stock, Series C | New York Stock Exchange |
| Depositary Shares representing 5.67% Cumulative Preferred Stock, Series D | New York Stock Exchange |
| Depositary Shares representing Fixed/Adjustable Rate Cumulative Preferred Stock, Series E | New York Stock Exchange |
| Depositary Shares representing 6.50% Cumulative Preferred Stock, Series F | New York Stock Exchange |
| Depositary Shares representing Floating Rate Cumulative Preferred Stock, Series G | New York Stock Exchange |
| 8% Trust Preferred Securities, Series I, of Subsidiary Trust (and Registrant' s guarantee thereof) | New York Stock Exchange |
| 7.875% Trust Preferred Securities, Series J, of Subsidiary Trust (and Registrant' s guarantee thereof) | New York Stock Exchange |
| 6.375% Trust Preferred Securities, Series K, of Subsidiary Trust (and Registrant' s guarantee thereof) | New York Stock Exchange |
| 6.375% Trust Preferred Securities, Series L, of Subsidiary Trust (and Registrant' s guarantee thereof) | New York Stock Exchange |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| Guarantee by Registrant of 7 5/8% Notes due 2006 of Lehman Brothers Inc. | New York Stock Exchange |
| 6% Yield Enhanced Equity Linked Debt Securities Due May 25, 2005, Performance Linked to LSI Logic Corporation (LSI) Common Stock | American Stock Exchange |
| 10 Uncommon Values Index Basket Adjusting Structured Equity Securities Notes Due 2004 | American Stock Exchange |
| 10 Uncommon Values Index Basket Adjusting Structured Equity Securities Notes, Series B, Due 2004 | American Stock Exchange |
| 10 Uncommon Values Index Risk Adjusting Equity Range Securities Plus Notes Due July 2, 2004 | American Stock Exchange |
| 10 Uncommon Values Index Stock Upside Note Securities Notes Due July 3, 2004 | American Stock Exchange |
| 10 Uncommon Values Index Stock Upside Note Securities Notes Due July 2, 2005 | American Stock Exchange |
| 21.68% Risk Adjusting Equity Range Securities Due February 7, 2005, Performance Linked to Cray Inc. (CRAY) Common Stock | American Stock Exchange |
| 17.00% Risk Adjusting Equity Range Securities due February 24, 2005, Performance Linked to Advanced Digital Information Corporation (ADIC) Common Stock | American Stock Exchange |
| Dow Jones Industrial Average 112.5% Minimum Redemption PrincipalPlus Stock Upside Note Securities Due August 5, 2007 | American Stock Exchange |
| Dow Jones Industrial Average Stock Upside Note Securities Due April 29, 2010 | American Stock Exchange |
| Dow Jones Internet Index Stock Upside Note Securities Due November 10, 2004 | American Stock Exchange |
| NASDAQ-100 Index 109% Minimum Redemption Stock Upside Note Securities Due April 26, 2004 | American Stock Exchange |
| NASDAQ-100 Index Rebound Risk Adjusting Equity Range Securities Notes Due May 20, 2007 | American Stock Exchange |
| Nikkei 225 Index SUNS Stock Upside Note Securities Due June 10, 2010 | American Stock Exchange |
| Notes due November 14, 2007-Performance Linked to Pfizer Inc. (PFE) Common Stock | American Stock Exchange |
| Prudential Research Universe Diversified Equity Notes Due December 29, 2004 | American Stock Exchange |
| Prudential Research Universe Diversified Equity Notes Due July 2, 2006, Linked to a Basket of Healthcare Stocks | American Stock Exchange |
| S&P 500 Index Stock Upside Note Securities Due April 30, 2005 | American Stock Exchange |
| S&P 500 Index Stock Upside Note Securities Due December 26, 2006 | American Stock Exchange |
| S&P 500 Index Stock Upside Note Securities Due February 5, 2007 | American Stock Exchange |
| S&P 500 Index Stock Upside Note Securities Due September 27, 2007 | American Stock Exchange |
| S&P 500 Index Stock Upside Note Securities Due August 5, 2008 | American Stock Exchange |
| S&P 500 Index Callable Stock Upside Note Securities due November 6, 2009 | American Stock Exchange |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant' s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☒ No ☐

The aggregate market value of the voting and nonvoting common equity held by non-affiliates of the Registrant at May 30, 2003 (the last business day of the Registrant' s most recently completed second fiscal quarter) was approximately $16,707,991,000. As of that date, 233,254,102 shares of the Registrant' s Common Stock, $0.10 par value per share, were held by non-affiliates. For purposes of this information, the outstanding shares of Common Stock that were and that may be deemed to have been beneficially owned by directors and executive officers of the Registrant were deemed to be shares of common stock held by affiliates at that date.

As of February 13, 2004, 277,256,627 shares of the Registrant' s Common Stock, $.10 par value per share, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

(1) Lehman Brothers Holdings Inc. 2003 Annual Report to Stockholders (the "2003 Annual Report")−Incorporated in part in Parts I, II and IV.

(2) Lehman Brothers Holdings Inc. Definitive Proxy Statement for its 2004 Annual Meeting of Stockholders (the "Proxy Statement")−Incorporated in part in Parts III and IV.

---

## TABLE OF CONTENTS


| | | |
|---|---|---|
| **AVAILABLE INFORMATION** | | 2 |
| **PART I** | | |
| ITEM 1. | BUSINESS | 3 |
| ITEM 2. | PROPERTIES | 13 |
| ITEM 3. | LEGAL PROCEEDINGS | 14 |
| ITEM 4. | SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS | 26 |
| **PART II** | | |
| ITEM 5. | MARKET FOR REGISTRANT' S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS | 26 |
| ITEM 6. | SELECTED FINANCIAL DATA | 26 |
| ITEM 7. | MANAGEMENT' S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS | 26 |
| ITEM 7A. | QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK | 26 |
| ITEM 8. | FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA | 26 |
| ITEM 9. | CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE | 26 |
| ITEM 9A. | CONTROLS AND PROCEDURES | 27 |
| **PART III** | | |
| ITEM 10. | DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT | 27 |
| ITEM 11. | EXECUTIVE COMPENSATION | 27 |
| ITEM 12. | SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT | 28 |
| ITEM 13. | CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS | 29 |
| ITEM 14. | PRINCIPAL ACCOUNTANT FEES AND SERVICES | 29 |
| **PART IV** | | |
| ITEM 15. | EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K | 30 |
| **SIGNATURES** | | 34 |
| **INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE** | | F-1 |
| **SCHEDULE I−CONDENSED FINANCIAL INFORMATION OF REGISTRANT** | | F-2 |
| **EXHIBIT INDEX** | | |
| **EXHIBITS** | | |


---

## AVAILABLE INFORMATION

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Lehman Brothers Holdings Inc. ("Holdings") files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). You may read and copy any document Holdings files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. Holdings' electronic SEC filings are available to the public at http://www.sec.gov.

Holdings' public internet site is http://www.lehman.com. Holdings makes available free of charge through its internet site, via a link to the SEC's internet site at http://www.sec.gov, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as soon as reasonably practicable after it electronically files such material with, or furnishes it to, the SEC. Holdings also makes available through its internet site, via a link to the SEC's internet site, statements of beneficial ownership of Holdings' equity securities filed by its directors, officers, 10% or greater shareholders and others under Section 16 of the Exchange Act.

In addition, Holdings currently makes available on http://www.lehman.com its most recent annual report on Form 10-K, its quarterly reports on Form 10-Q for the current fiscal year, its most recent proxy statement and its most recent annual report to stockholders, although in some cases these documents are not available on that site as soon as they are available on the SEC's site.

Holdings also makes available on http://www.lehman.com (i) its Corporate Governance Guidelines, (ii) its Code of Ethics (including any waivers therefrom granted to executive officers or directors), and (iii) the charters of the Audit, Compensation and Benefits, and Nominating and Corporate Governance Committees of its Board of Directors. These documents are also available in print without charge to any person who requests them by writing or telephoning:

Lehman Brothers Holdings Inc.
Office of the Corporate Secretary
399 Park Avenue
New York, New York 10022
(212) 526-0858

In order to view and print the documents referred to above on Holdings' internet site, which are in the .PDF format, you will need to have on your computer the Adobe Acrobat Reader software. If you do not have Adobe Acrobat, a link to Adobe Systems Incorporated's internet site, from which you can download the software, is provided.



---

## PART I

### ITEM 1. BUSINESS

As used herein, "Holdings" or the "Registrant" means Lehman Brothers Holdings Inc., a Delaware corporation, incorporated on December 29, 1983. Holdings and its subsidiaries are collectively referred to as the "Company," the "Firm" or "Lehman Brothers."

The Company is one of the leading global investment banks, serving institutional, corporate, government and high-net-worth individual clients and customers. Its executive offices are located at 745 Seventh Avenue, New York, New York 10019, and its telephone number is (212) 526-7000.

**Forward-Looking Statements**

Some of the statements contained or incorporated by reference in this Report, including those relating to the Company's strategy and other statements that are predictive in nature, that depend upon or refer to future events or conditions, or that include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates" and similar expressions, are forward-looking statements within the meaning of Section 21E of the Exchange Act. These statements are not historical facts but instead represent only the Firm's expectations, estimates and

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

projections regarding future events. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict, which may include, but are not limited to, the factors listed below. As a global investment bank, the Company' s results of operations have varied significantly in response to global economic and market trends and geopolitical events. The nature of the Company' s business makes predicting the future trends of revenues difficult. Caution should be used when extrapolating historical results to future periods.

The Company' s actual results and financial condition may differ, perhaps materially, from the anticipated results and financial condition in any such forward-looking statements and, accordingly, readers are cautioned not to place undue reliance on such statements. The Company undertakes no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

*Market Fluctuations and Volatility.* Changes in interest and foreign exchange rates, securities, commodities and real estate valuations and increases in volatility can increase credit and market risks and may also impact customer-flow-related revenues and proprietary trading revenues as well as impact the volume of debt and equity underwritings and merger and acquisition transactions. The Company uses derivatives and other financial contracts to hedge many of these market risks.

*Industry Competition and Changes in Competitive Environment.* Increased competition from banking institutions, asset managers and non-traditional financial services providers and industry consolidation could impact fees earned from the Company' s Investment Banking, Client Services and Capital Markets businesses.

*Investor Sentiment.* Recent accounting and corporate governance scandals have had a significant impact on investor confidence. In addition, geopolitical concerns about terrorist activities can affect the global financial markets.

*Liquidity.* Liquidity and liquidity management are of critical importance to the Company. Liquidity could be impacted by the inability to access the long-term or short-term debt markets or the repurchase and securities-lending markets. However, the Company' s liquidity and funding policies have been designed with the goal of providing sufficient liquidity resources to continually fund its balance sheet and to meet its obligations in all market environments.

*Credit Ratings.* The Company' s access to the unsecured funding markets is dependent upon the Company' s credit ratings. A reduction in the Company' s credit ratings could adversely affect the Company' s access to liquidity alternatives and its competitive position, and could increase the cost of funding or trigger additional collateral requirements.



*Credit Exposure.* Credit risk represents the possibility that a counterparty will be unable to honor its contractual obligations to the Company. Although the Company actively manages credit risk exposure daily as part of its risk management framework, counterparty default risk may arise from unforeseen events or circumstances.

*Legal/Regulatory.* Legal and regulatory changes in the United States and other jurisdictions could have unfavorable effects on the Company' s businesses and results of operations. In particular, there have been a number of legislative, legal and regulatory developments related to research analyst conflicts of interest and mutual fund trading issues in the financial services industry that may affect future results of operations. In 2002 the U.S. Congress enacted the Sarbanes-Oxley Act, which significantly affected corporate governance and securities laws. In addition, various federal and state securities regulators, self-regulatory organizations (including the New York Stock Exchange) and industry participants reviewed and, in many cases, adopted significant changes to their established rules, including rules in the areas of corporate governance, potential research analyst conflicts of interest and auditor independence. See “Business−Regulation” below.

*Neuberger Berman Integration.* The Company acquired Neuberger Berman Inc. and its subsidiaries, an asset management company, in October 2003. The Company' s ability to achieve the anticipated benefits of the merger, including revenue and cost synergies, is dependent upon a number of factors, certain of which may be beyond the Company' s control. These synergies may not be realized in the anticipated amounts or time frame. For additional information about this acquisition see “Client Services−Asset Management” below and “Management' s Discussion and Analysis−Results of Operations−Business Acquisitions” and “−Segments−Client Services” and Note 6 to the Consolidated Financial Statements in the 2003 Annual Report.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

For more information concerning the risks and other factors that could affect the Firm' s future results and financial condition, see "Management' s Discussion and Analysis" in the 2003 Annual Report.

**LEHMAN BROTHERS**

Lehman Brothers is one of the leading global investment banks, serving institutional, corporate, government and high-net-worth individual clients and customers. The Company' s worldwide headquarters in New York and regional headquarters in London and Tokyo are complemented by offices in additional locations in the United States, Europe, the Middle East, Latin America and the Asia Pacific region. The Company is engaged primarily in providing financial services. Other businesses in which the Company is engaged represent less than 10 percent of each of consolidated assets, revenues and pre-tax income.

The Company' s business includes capital raising for clients through securities underwriting and direct placements, corporate finance and strategic advisory services, securities sales and trading, research, the trading of foreign exchange and derivative products and certain commodities, asset management for high-net-worth and institutional clients and private equity investments. The Company acts as a market-maker in all major equity and fixed income products in both the U.S. and international markets. Lehman Brothers is a member of all principal securities and commodities exchanges in the United States, as well as NASD, Inc., and holds memberships or associate memberships on several principal international securities and commodities exchanges, including the London, Tokyo, Hong Kong, Frankfurt, Paris and Milan stock exchanges.

Lehman Brothers provides a full array of capital markets products, investment banking services and investment management and advisory services worldwide. Through the Company' s investment banking, trading, research, structuring and distribution capabilities in equity and fixed income products, the Company continues its focus of building its client/customer business model. This "customer flow" model is based on facilitating customer transactions in all major global capital markets products and services. The Company generates customer flow revenues from institutional and high-net-worth clients and customers by (i) advising on and structuring transactions specifically suited to meet client needs; (ii) serving as a market maker and/or intermediary in the global marketplace, including making securities and other financial instrument products available to clients to rebalance their portfolios and diversify risks across different market cycles; (iii) providing asset management services to high-net-worth and institutional clients; and



(iv) acting as an underwriter to clients. Customer flow activities represent a preponderance of the Company' s revenues. In addition, the Company also takes proprietary positions, the success of which is dependent on its ability to anticipate economic and market trends. The Company believes its customer flow orientation helps to mitigate its overall revenue volatility.

The Company operates in three business segments (each of which is described below): Investment Banking, Capital Markets and Client Services. Financial information concerning the Company for the fiscal years ended November 30, 2003, November 30, 2002, and November 30, 2001, including the amount of net revenue contributed by each segment in such periods, is set forth in the Consolidated Financial Statements and the Notes thereto in the 2003 Annual Report and is incorporated herein by reference. Information with respect to the Company' s operations by segment and net revenues by geographic area is set forth under the captions "Management' s Discussion and Analysis−Segments" and "−Geographic Diversification" and in Note 22 of the Notes to Consolidated Financial Statements in the 2003 Annual Report and is incorporated herein by reference.

**Investment Banking**

The Investment Banking Division provides advice to corporate, institutional and government clients throughout the world on mergers, acquisitions and other financial matters. Investment Banking also raises capital for clients by underwriting public and private offerings of debt and equity securities. Lehman Brothers' Investment Banking professionals are responsible for developing and maintaining relationships with issuer clients, gaining a thorough understanding of their specific needs and bringing together the full resources of Lehman Brothers to accomplish their financial and strategic objectives. Investment Banking is organized into industry, product and geographic coverage groups, enabling individual bankers to develop specific expertise in particular industries and markets. Industry coverage groups include Communications and Media, Consumer/Retailing, Financial Institutions, Financial Sponsors, Healthcare, Industrial, Natural Resources,

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Power, Real Estate and Technology. Specialized product groups within Mergers and Acquisitions and Global Finance are partnered with global relationship managers in the global industry groups to provide comprehensive solutions for clients. Specialists in product development and derivatives also are engaged to tailor specific structures for clients. Global Finance encompasses Equity Capital Markets, which consists of equity and equity-related securities and derivatives, Debt Capital Markets, which incorporates expertise in syndicate, liability management, derivatives and bank loan syndication, Leveraged Finance and Private Placements. Geographically, Lehman Brothers maintains investment banking offices in seven cities in the U.S. and in sixteen cities in Europe, the Middle East, Asia and Latin America. The high degree of integration among the Company' s industry, product and geographic groups has allowed Lehman Brothers to become a leading source of one-stop financial solutions for its global clients.

*Underwriting.* The Company is a leading underwriter of initial and other public and private offerings of equity and fixed income securities, including listed and over-the-counter securities, government and agency securities and mortgage- and asset-backed securities.

*Mergers & Acquisitions/Strategic Advisory.* Lehman Brothers has a long history of providing strategic advisory services to corporate, institutional and government clients around the world on a wide range of financial matters, including mergers and acquisitions, restructurings and spin-offs, targeted stock transactions, share repurchase strategies, government privatization programs, takeover defenses and other strategic advice.

**Capital Markets**

The Capital Markets segment includes institutional customer flow activities, research and secondary-trading and financing activities in fixed income and equity products. These products include a wide range of cash, derivative, secured financing and structured instruments and investments. The Company is a leading global market-maker in numerous equity and fixed income products including U.S., European and Asian equities, government and agency securities, money market products, corporate high grade, high yield and emerging market securities, mortgage- and asset-backed securities and real estate, preferred stock, municipal securities, bank loans, foreign exchange, financing and derivative products. The Company is one of the largest investment banks in terms of U.S. and pan-European listed equities trading volume and maintains a major presence in over-the-counter U.S. stocks, major Asian large



capitalization stocks, warrants, convertible debentures and preferred issues. The Capital Markets segment also includes the risk arbitrage and secured financing businesses as well as realized and unrealized gains and losses related to private equity investments. Lehman Brothers combines the skills from the sales, trading and research areas of its Equities and Fixed Income Divisions to serve the financial needs of the Company' s clients and customers. This integrated approach enables Lehman Brothers to structure and execute global transactions for clients and to provide worldwide liquidity in marketable securities.

***Equities***

The Equities group is responsible for the Company' s equity operations and all dollar and non-dollar equity and equity-related products worldwide. These products include listed and over-the-counter securities, American Depositary Receipts, convertibles, options, warrants and derivatives.

*Equity Cash Products.* Lehman Brothers makes markets in equity and equity-related securities, and executes block trades on behalf of clients and customers. The Company participates in the global equity and equity-related markets in all major currencies through its worldwide presence and membership in major stock exchanges, including, among others, those in New York, London, Tokyo, Hong Kong, Frankfurt, Paris and Milan.

*Equity Derivatives.* Lehman Brothers offers equity derivative capabilities across a wide spectrum of products and currencies, including domestic and international portfolio trading, listed options and futures and over-the-counter derivatives. The Firm' s equity derivatives business is organized into two major product areas: a global volatility business, encompassing options-related products, and a global portfolio trading business that specializes in agency/risk baskets and other structured products.

*Equity Finance and Prime Broker.* Lehman Brothers maintains an integrated equity financing and prime broker business to provide liquidity to its clients and customers and supply a source of secured financing for the Firm. Equity Financing provides financing in all markets on a margin basis for customer purchases of equities and other capital markets products as well as securities lending and short-selling facilitation. The Prime Broker business also engages in full operations, clearing and processing services for that unit' s customers.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

*Arbitrage.* Lehman Brothers engages in a variety of arbitrage activities including "riskless" arbitrage, where the Company seeks to benefit from temporary price discrepancies that occur when a security is traded in two or more markets, and "risk" arbitrage activities, which involve the purchase of securities at discounts from the expected values that would be realized if certain proposed or anticipated corporate transactions (such as mergers, acquisitions, recapitalizations, exchange offers, reorganizations, bankruptcies, liquidations or spin-offs) were to occur. Lehman Brothers' arbitrage activities benefit from the Company' s presence in the global capital markets, access to advanced information technology, in-depth market research, proprietary risk management tools and general experience in assessing rapidly changing market conditions.

***Fixed Income***

Lehman Brothers actively participates in key fixed income markets worldwide and maintains a 24-hour trading presence in global fixed income securities. The Company is a preeminent market-maker in new issue and other fixed income securities. Fixed Income businesses include the following:

*Government and Agency Obligations.* Lehman Brothers is one of the leading primary dealers in U.S. government securities, participating in the underwriting and market-making of U.S. Treasury bills, notes and bonds, and securities of federal agencies. The Company is also a market-maker in the government securities of all G7 countries, and participates in other major European and Asian government bond markets.

*Corporate Debt Securities and Loans.* Lehman Brothers makes markets in fixed and floating rate investment grade debt worldwide. The Company is also a major participant in the preferred stock market, managing numerous offerings of long-term and perpetual preferreds and auction rate securities.



*High Yield Securities and Leveraged Bank Loans.* The Company also makes markets in non-investment grade debt securities and bank loans. Lehman Brothers provides "one-stop" leveraged financing solutions for corporate and financial acquirers and high yield issuers, including multi-tranche, multi-product acquisition financing. The Company remains one of the leading investment banks in the syndication of leveraged loans.

*Money Market Products.* Lehman Brothers holds leading market positions in the origination and distribution of medium-term notes and commercial paper. The Company is an appointed dealer or agent for numerous active commercial paper and medium-term note programs on behalf of companies and government agencies worldwide.

*Mortgage- and Asset-Backed Securities.* The Company is a leading underwriter of and market-maker in residential and commercial mortgage- and asset-backed securities and is active in all areas of secured lending, structured finance and securitized products. Lehman Brothers underwrites and makes markets in the full range of U.S. agency-backed mortgage products, mortgage-backed securities, asset-backed securities and whole loan products. It is also a leader in the global market for residential and commercial mortgages (including multi-family financing) and leases. The Company originates commercial and residential mortgage loans through the Company' s domestic savings bank, Lehman Brothers Bank, FSB, and other subsidiaries. Lehman Brothers Bank offers traditional and online mortgage and banking services nationally to individuals as well as institutions and their customers. The Bank is a major part of the Firm' s institutional mortgage business, providing an origination pipeline for mortgages and asset-backed securities.

During 2003, the Company acquired controlling interests in two residential mortgage loan originator/servicers. The Company believes these acquisition will allow further vertical integration of the mortgage business platform. Mortgage loans originated by these companies are intended to provide a more cost efficient source of loan product for the Company' s securitization pipeline.

*Real Estate Investment.* In addition to its lending activities, the Company invests in commercial and residential real estate (both existing properties and development projects) in the form of joint venture equity investments as well as direct ownership interests. The Company has interests in several hundred properties throughout the world.

*Municipal and Tax-Exempt Securities.* Lehman Brothers is a major dealer in municipal and tax-exempt securities, including general obligation and revenue bonds, notes issued by states, counties, cities, and state and local governmental agencies, municipal leases, tax-exempt commercial paper and put bonds.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

*Financing.* The Financing unit engages in three primary functions: managing the Company' s matched book activities, supplying secured financing to institutional clients and customers and providing secured funding for the Company' s activities. Matched book funding involves borrowing and lending cash on a short-term basis to institutional customers collateralized by marketable securities, typically government or government agency securities. The Company enters into these agreements in various currencies and seeks to generate profits from the difference between interest earned and interest paid. The Financing unit works with the Company' s institutional sales force to identify customers that have cash to invest and/or securities to pledge to meet the financing and investment objectives of the Company and its customers. Financing also coordinates with the Company' s Treasury area to provide collateralized financing for a large portion of the Company' s securities and other financial instruments owned. In addition to its activities on behalf of its U.S. clients and customers, the Company is a major participant in the European and Asian repurchase agreement markets, providing secured financing for the Firm' s customers in those regions.

*Fixed Income Derivatives.* The Company offers a broad range of derivative, interest rate and credit products and services. Derivatives professionals are integrated into all of the Company' s fixed income areas in response to the worldwide convergence of the cash and derivative markets.

*Foreign Exchange.* Lehman Brothers' global foreign exchange operations provide market access and liquidity in all currencies for spot, forward and over-the-counter options markets around the clock. Lehman Brothers offers its customers superior execution, market information, analysis and hedging capabilities, utilizing foreign exchange as well as foreign exchange options and derivatives. Lehman Brothers also provides advisory services to central banks, corporations and investors worldwide, structuring innovative products to fit their specific needs. The Firm makes extensive use of its global macroeconomics research to advise clients on the appropriate strategies to minimize interest



rate and currency risk.

***Global Distribution***

Lehman Brothers' institutional sales organizations encompass distinct global sales forces that have been integrated into the Capital Markets businesses to provide investors with the full array of products and research offered by the Firm.

*Equity Sales.* Lehman Brothers' institutional Equities sales force provides an extensive range of services to institutional investors through locations in the U.S., Europe and Asia. The Equity sales organization focuses on developing long-term relationships though a comprehensive understanding of customers' investment objectives, while providing proficient execution and consistent liquidity in a wide range of global equity securities and derivatives.

*Fixed Income Sales.* Lehman Brothers' Fixed Income sales force is one of the most productive in the industry, serving the investing and liquidity needs of major institutional investors by employing a relationship management approach that provides superior information flow and product opportunities for the Firm' s customers.

***Research***

Research at Lehman Brothers encompasses the full range of research disciplines, including quantitative, economic, strategic, credit, relative value and market-specific analysis.

*Equity Research*. To ensure in-depth expertise within various markets, Equity Research has established regional teams on a worldwide basis that are staffed with industry and strategy specialists.

*Fixed Income Research.* The Firm' s Fixed Income Research specialists provide expertise in U.S., European and Asian government and agency securities, derivatives, sovereign issues, corporate securities, high yield, asset- and mortgage-backed securities, indices, emerging market debt and municipal securities.

**Client Services**

Client Services consists of the Company' s Private Client and Asset Management businesses.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

***Private Client Services***

The Company' s Private Client Services business generates customer flow transactional revenues by serving the investment needs of private investors with substantial assets as well as thousands of mid-sized institutional accounts worldwide. The group has investment representatives located in 14 offices around the globe. Investment professionals provide their clients with direct access to investment banking, fixed income, equity, foreign exchange and derivative products, as well as the Firm' s research and execution capabilities.

***Asset Management***

Asset Management generates fee-based revenues from customized investment management services for high-net-worth clients as well as asset management fees from mutual fund and other institutional investors. Lehman Brothers has been expanding its asset management activities to focus on the strategic development of a comprehensive asset management platform for the Firm, drawing on−and providing both individual and institutional clients with access to−Lehman Brothers' investment advisory expertise across various asset classes and geographies.

The Company significantly enhanced its market position in asset management in October 2003 through the acquisition of Neuberger Berman Inc. Neuberger Berman is a leading asset management firm that provides wealth management services (private asset management, estate planning, tax planning, trust and fiduciary services); manages and advises open-end and closed-end mutual funds, institutional separate accounts and wrap accounts sponsored by third party brokerage firms and banks; and provides professional investor clearing services. This acquisition positions the Company as a leading provider of services to high-net-worth investors. The Company believes the acquisition will



provide revenue synergies by making Neuberger Berman products available to the Lehman Brothers network of institutional and high-net-worth individual clients and offering Neuberger Berman clients an expanded range of investment and risk management products, including structured capital markets products, private equity and other alternative asset management products. The Company intends for the Neuberger Berman brand to remain intact.

In January 2003, the Company acquired the fixed income asset management business of Lincoln Capital Management, which is the Firm' s primary U.S. institutional fixed income management platform for large institutional investors. In July 2003, the Company launched Lehman Brothers First Trust Income Opportunity Fund, a new closed-end management investment company with the investment objective to seek high total return by investing primarily in high yield debt securities. Other asset management initiatives in recent years include Lehman Brothers Alternative Investment Management (the Firm' s joint venture with Ehrenkranz & Ehrenkranz).

Lehman Brothers also provides Investment Consulting Services, a wrap-fee series of third party managed products, management of multiple manager funds onshore and offshore and a managed futures advisory business. In addition, the Firm also has dealer agreements with a large number of mutual fund families.

In addition, Asset Management generates management and incentive fees from the Company' s role as general partner for private equity and alternative investment partnerships. The Company' s Private Equity business operates in five major asset classes: Merchant Banking, Venture Capital, Real Estate, Fixed Income-related and Third Party Funds. The primary goal of each asset class is to make investments that provide attractive risk-adjusted returns to investors, including institutions, high-net-worth individuals, the Firm and certain employees of the Firm. The Company has raised privately-placed funds in all of these classes, for which the Company acts as general partner. In addition, the Company generally co-invests directly in the investments made by the funds and occasionally makes other non-fund-related direct investments. (Gains and losses related to proprietary private equity investments are included in the results of the Capital Markets segment.) In October 2003, the Company acquired substantially all of the operating assets of The Crossroads Group ("Crossroads"), a diversified private equity fund manager, which significantly expanded the Company' s global private equity assets under management.

The Neuberger Berman LibertyView division manages several alternative investment master funds. Their investment products include both multi-strategy and single strategy funds that focus on achieving market neutral returns utilizing equity, credit, volatility and mortgage-backed arbitrage trading strategies.

**Corporate**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company’ s Corporate division provides support to its businesses through the processing of certain securities and commodities transactions; receipt, identification and delivery of funds and securities; safeguarding of customers’ securities; risk management; and compliance with regulatory and legal requirements. In addition, this staff is responsible for technology infrastructure and systems development, treasury operations, financial control and analysis, tax planning and compliance, internal audit, expense management, career development and recruiting and other support functions.

**Risk Management**

As a leading global investment banking company, risk is an inherent part of the Company’ s businesses. Global markets, by their nature, are prone to uncertainty and subject participants to a variety of risks. Lehman Brothers has developed policies and procedures designed to identify, measure and monitor each of the risks involved in its trading, brokerage and investment banking activities on a global basis. The principal risks of Lehman Brothers are market, credit, liquidity, legal and operational risks. Risk management is considered to be of paramount importance in the Company’ s day-to-day operations. Consequently, the Company devotes significant resources (including investments in personnel and technology) across all of its worldwide trading operations to the measurement, analysis and management of risk.

The Company seeks to reduce risk through the diversification of its businesses, counterparties and activities in geographic regions. The Company accomplishes this objective by allocating the usage of capital to each of its businesses, establishing trading limits and setting credit limits for individual counterparties, including regional concentrations. The Company seeks to achieve adequate returns from each of its businesses commensurate with the risks



they assume. Nonetheless, the effectiveness of the Company’ s policies and procedures for managing risk exposure can never be completely or accurately predicted or fully assured. For example, unexpectedly large or rapid movements or disruptions in one or more markets or other unforeseen developments can have an adverse effect on the Company’ s results of operations and financial condition. The consequences of these developments can include losses due to adverse changes in inventory values, decreases in the liquidity of trading positions, higher volatility in the Company’ s earnings, increases in the Company’ s credit exposure to customers and counterparties and increases in general systemic risk. If any of the strategies used to hedge or otherwise mitigate exposures to the various types of risks described above are not effective, the Company could incur losses.

Lehman Brothers has developed a control infrastructure to monitor and manage each type of risk on a global basis throughout the Company. A full description of the Firm’ s Risk Management infrastructure and procedures is contained in “Management’ s Discussion and Analysis−Risk Management” in the 2003 Annual Report, and is incorporated herein by reference. Information regarding the Company’ s use of derivative financial instruments to hedge interest rate, currency, security and commodity price and other market risks is contained in Notes 1 and 3 to the Consolidated Financial Statements in the 2003 Annual Report, and is incorporated herein by reference.

**Competition**

All aspects of the Company’ s business are highly competitive. The Company competes in U.S. and international markets directly with numerous other firms in the areas of securities underwriting and placement, corporate finance and strategic advisory services, securities sales and trading, research, foreign exchange and derivative products, asset management and private equity, including investment banking firms, traditional and online securities brokerage firms, mutual fund companies and other asset managers, investment advisers, venture capital firms and certain commercial banks and, indirectly for investment funds, with insurance companies and others. Lehman Brothers’ competitive ability depends on many factors, including its reputation, the quality of its services and advice, product innovation, execution ability, pricing, advertising and sales efforts and the talent of its personnel.

The financial services industry has become considerably more concentrated as numerous securities firms have been acquired by or merged into other firms. These developments have increased competition from other firms, many of which have significantly greater equity capital than the Company. Legislative and regulatory changes in the United States allow commercial banks to enter businesses previously limited to

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

investment banks, and several large commercial banks, insurance companies and other broad-based financial services firms have established or acquired broker-dealers or have merged with other financial institutions. Many of these firms have greater capital than the Company and have the ability to offer a wide range of products, from loans, deposit-taking and insurance to brokerage, asset management and investment banking services, which may enhance their competitive position. They also have the ability to support their investment banking and securities products with commercial banking, insurance and other financial services revenues in an effort to gain market share, which could result in pricing pressure in the Company' s businesses. Moreover, the Firm has faced, and expects to continue to face, pressure to retain market share by committing capital to businesses or transactions on terms that offer returns that may not be commensurate with their risks. In particular, corporate clients sometimes seek to require lending and other commitments from financial services firms in connection with investment banking assignments. In addition, the trend towards consolidation and globalization presents infrastructure, technology, risk management and other challenges.

Lehman Brothers has experienced intense price competition in some of its businesses in recent years. For example, equity and debt underwriting discounts, as well as trading spreads, have been under pressure for a number of years, and the ability to execute trades electronically, through the internet and through other alternative trading systems, has increased the pressure on trading commissions. It appears that this trend toward alternative trading systems will continue. The Company may experience competitive pressures in these and other areas in the future as some of its competitors seek to obtain market share by reducing prices.

The Company also faces competition in attracting and retaining qualified employees. Our ability to continue to compete effectively in our businesses will depend upon our ability to attract new employees and retain and motivate our existing employees while managing compensation costs.



**Regulation**

The securities industry in the United States is subject to extensive regulation under both federal and state laws. Lehman Brothers Inc. ("LBI"), Neuberger Berman, LLC ("NB LLC") and Neuberger Berman Management Inc. ("NBMI") are registered with the SEC as broker-dealers; and LBI, NB LLC, NBMI, Lincoln Capital Fixed Income Management LLC ("Lincoln Capital"), certain Crossroads entities and certain other subsidiaries of Holdings are registered with the SEC as investment advisers. As such these entities are subject to regulation by the SEC and by self-regulatory organizations, principally the NASD (which has been designated by the SEC as NBMI' s primary regulator), national securities exchanges such as the New York Stock Exchange ("NYSE") (which has been designated by the SEC as LBI' s and NB LLC' s primary regulator) and the Municipal Securities Rulemaking Board, among others. Securities firms are also subject to regulation by state securities administrators in those states in which they conduct business. Various subsidiaries of Holdings are registered as broker-dealers in all 50 states, the District of Columbia and the Commonwealth of Puerto Rico.

Broker-dealers are subject to regulations that cover all aspects of the securities business, including sales practices, market making and trading among broker-dealers, publication of research, margin lending, use and safekeeping of clients' funds and securities, capital structure, recordkeeping and the conduct of directors, officers and employees.

Registered investment advisers are subject to regulations under the Investment Advisers Act of 1940. Such requirements relate to, among other things, recordkeeping and reporting requirements, disclosure requirements, limitations on agency cross and principal transactions between an adviser and advisory clients, as well as general anti-fraud prohibitions.

Certain investment funds managed by the Company are registered investment companies under the Investment Company Act of 1940. Those funds and the Lehman Brothers entities that serve as the funds' investment advisers are subject to that act and the rules thereunder, which, among other things, regulate the relationship between a registered investment company and its investment adviser and prohibit or severely restrict principal transactions and joint transactions.

Violation of applicable regulations can result in legal and/or administrative proceedings, which may impose censures, fines, cease-and-desist orders or suspension or expulsion of a broker-dealer or an investment adviser, its officers or employees.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

LBI and NB LLC are also registered with the Commodity Futures Trading Commission (the "CFTC") as futures commission merchants; and NB LLC, Lincoln Capital and other subsidiaries are registered as commodity pool operators and/or commodity trading advisers. These entities are subject to regulation as such by the CFTC and various domestic boards of trade and other commodity exchanges. The Company' s U.S. commodity futures and options business is also regulated by the National Futures Association, a not-for-profit membership corporation that has been designated as a registered futures association by the CFTC.

The Sarbanes-Oxley Act of 2002 and rules promulgated by the SEC and the NYSE in response thereto have imposed substantial new or toughened regulations and disclosure requirements in the areas of corporate governance (including director independence, director selection and audit and compensation committee responsibilities), equity compensation plans, auditor independence, pre-approval of auditor fees and services and disclosure and internal control procedures. Lehman Brothers is committed to industry best practices in these areas and believes it is in compliance with the relevant rules and regulations.

The USA Patriot Act of 2001, enacted in response to the terrorist attacks on September 11, 2001, contains anti-money laundering and financial transparency laws and mandates the implementation of various new regulations applicable to broker-dealers, futures commission merchants and other financial services companies, including standards for verifying client identification at account opening, and obligations to monitor client transactions and report suspicious activities. Through these and other provisions, the Patriot Act seeks to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. Anti-money laundering laws outside of the U.S. contain some similar provisions. The increased obligations of financial institutions to identify their customers, watch for and report suspicious transactions, respond to requests for information by regulatory authorities and law enforcement agencies, and share information with other financial institutions, require the



implementation and maintenance of internal practices, procedures and controls which may subject the Company to liability.

The Company does business in the international fixed income and equity markets and undertakes international investment banking activities, principally through its regional headquarters in London and Tokyo. Holdings' subsidiary, Lehman Brothers International (Europe) ("LBIE"), is an authorized investment firm in the United Kingdom and is a member of the London, Frankfurt, Paris and Milan exchanges, among others. The U.K. Financial Services and Markets Act 2000 (the "FSMA") governs all aspects of the United Kingdom investment business, including regulatory capital, sales and trading practices, use and safekeeping of customer funds and securities, record keeping, margin practices and procedures, approval standards for individuals, periodic reporting and settlement procedures. Pursuant to the FSMA, certain subsidiaries of Holdings are subject to regulations promulgated and administered by the Financial Services Authority.

Holdings' subsidiary, Lehman Brothers Japan Inc. ("LBJ"), is a registered securities company in Japan and a member of the Tokyo Stock Exchange Limited, the Osaka Stock Exchange Limited and the Tokyo Financial Futures Exchange and, as such, is regulated by the Financial Services Agency, the Japan Securities Dealers Association and such exchanges.

Lehman Brothers Bank, FSB, the Company' s thrift subsidiary, is regulated by the Office of Thrift Supervision. Lehman Brothers Bankhaus A.G. is regulated by the German Federal Banking Authority. Neuberger Berman Trust Company, N.A., which holds a national bank charter, is regulated by the Office of the Comptroller of the Currency of the United States. Neuberger Berman Trust Company of Delaware, a non-depository limited purpose trust company, is subject to oversight by the State Bank Commissioner of the State of Delaware. These bodies regulate such matters as policies and procedures relating to conflicts of interest, account administration and overall governance and supervisory procedures.

LBI, LBIE, LBJ and Holdings' other subsidiaries are also subject to regulation by securities, banking and finance regulatory authorities, securities exchanges and other self-regulatory organizations in numerous other countries in which they do business.

Additional legislation and regulations, including those relating to the activities of broker-dealers and investment advisers, changes in rules imposed by the SEC or other U.S. or foreign regulatory authorities and self-regulatory organizations or changes in the interpretation or enforcement of existing laws and rules may adversely affect the Company' s business and profitability. The Company' s businesses may be

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

materially affected not only by regulations applicable to them as a broker-dealer, futures commission merchant, investment adviser, bank, etc., but also by regulations of general application, including existing and proposed tax legislation and other governmental regulations and policies (including the interest rate policies of the Federal Reserve Board and foreign central banks) and changes in the interpretation or enforcement of existing laws and rules that affect the business and financial communities.

The Company believes that it is in material compliance with applicable regulations.

**Capital Requirements**

LBI, NB LLC, NBMI, LBIE, the Tokyo branch of Lehman Brothers Japan Inc., Lehman Brothers Bank, Holdings' "AAA" rated derivatives subsidiaries, Lehman Brothers Financial Products Inc. and Lehman Brothers Derivative Products Inc., Neuberger Berman Trust Company, N.A., Neuberger Berman Trust Company of Delaware and others of Holdings' subsidiaries are subject to various capital adequacy requirements promulgated by the regulatory, banking and exchange authorities of the countries in which they operate and/or to capital targets established by various ratings agencies. The regulatory rules referred to above, and certain covenants contained in various debt agreements, may restrict Holdings' ability to withdraw capital from its regulated subsidiaries, which in turn could limit its ability to commit capital to other businesses, meet obligations or pay dividends to shareholders. Further information about these requirements and restrictions is contained in "Management's Discussion and Analysis−Liquidity, Funding and Capital Resources" and in Note 17 of the Notes to Consolidated Financial Statements in the 2003 Annual Report, and is incorporated herein by reference.



---

**Client Protection**

LBI and NB LLC are members of the Securities Investor Protection Corporation ("SIPC"). Clients of LBI and NB LLC are protected by SIPC against some losses. SIPC provides protection against lost, stolen or missing securities (except loss in value due to a rise or fall in market prices) for clients in the event of the failure of the broker-dealer. Accounts are protected up to $500,000 per client with a limit of $100,000 for cash balances. In addition to being members of SIPC, LBI and NB LLC carry excess SIPC protection which increases each client's protection up to the net equity of the account, subject to terms and conditions similar to SIPC. Like SIPC, the excess coverage does not apply to loss in value due to a rise or fall in market prices. Certain of Holdings' non-U.S. broker-dealer subsidiaries participate in programs similar to SIPC in certain jurisdictions.

**Insurance**

The Company maintains insurance coverage in types and amounts and with deductibles that management believes are customary for companies of similar size and engaged in similar businesses. However, the insurance market is volatile, and there can be no assurance that any particular coverages will be available in the future on terms acceptable to the Company.

**Employees**

As of November 30, 2003, the Company employed approximately 16,200 persons, including 11,700 in North America and 4,500 internationally. The Company considers its relationship with its employees to be good. The Neuberger Berman acquisition resulted in an increase of approximately 1,200 employees, and the Crossroads, Lincoln Capital and mortgage company acquisitions added approximately 2,200 employees.

**ITEM 2. PROPERTIES**

The Company's world headquarters is a 1,000,000 square-foot, owned office tower at 745 Seventh Avenue in New York City. In addition, the Company leases approximately 1,700,000 square feet of office space in the New York metropolitan area.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company leases or has options to lease a total of approximately 715,000 additional square feet of space at One World Financial Center, which it had occupied or had planned to occupy prior to September 11, 2001. A portion of this space has been sublet, and the Company continues to explore sublease alternatives and other options with respect to this facility.

In addition to its offices in the New York area, the Company has offices in over 120 locations in the Americas.

The Company also has offices in Europe and Asia. In Europe, the Company leases approximately 1,600,000 square feet of office space, including its new European headquarters in London, England, in the Canary Wharf development, east of the City of London. In addition to its European headquarters, the Company has an additional 19 offices in Europe.

In Asia, the Company is in the process of relocating its Asian headquarters to approximately 157,000 square feet of leased office space in the Roppongi Hills area of central Tokyo, Japan. The Company leases office space in 12 other locations in Asia.

All three of the Company' s business segments (as described herein) use the occupied facilities described above. Facilities occupied by the Company are believed to be adequate for the purposes for which they are used, and the occupied facilities are well maintained.

Additional information with respect to facilities, certain charges related thereto and lease commitments is set forth under the caption "Lease Commitments" in Note 11 and in Note 21 of the Notes to Consolidated Financial Statements in the



2003 Annual Report and is incorporated herein by reference.

**ITEM 3. LEGAL PROCEEDINGS**

The Company is involved in a number of judicial, regulatory and arbitration proceedings concerning matters arising in connection with the conduct of its business. Such proceedings include actions brought against the Company and others with respect to transactions in which the Company acted as an underwriter or financial advisor, actions arising out of the Company' s activities as a broker or dealer in securities and commodities and actions brought on behalf of various classes of claimants against many securities and commodities firms, including the Company.

Although there can be no assurance as to the ultimate outcome, the Company generally has denied, or believes it has a meritorious defense and will deny, liability in all significant cases pending against it including the matters described below, and it intends to defend vigorously each such case. Based on information currently available, analysis of insurance coverage and established reserves, the Company believes that the eventual outcome of the actions against it, including the matters described below, will not, in the aggregate, have a material adverse effect on the consolidated financial position or cash flows of the Company but may be material to the Company' s operating results for any particular period, depending on the level of the Company' s income for such period.

*Research Analyst Independence Litigations*

On April 28, 2003, a final global regulatory settlement regarding alleged research analyst conflicts of interest at various investment banking firms (the "Final Global Settlement") was announced, involving several of the leading securities firms in the United States, including LBI, and various federal and state regulators and self-regulatory organizations. Without admitting or denying any of the allegations of violations of certain NASD and New York Stock Exchange ("NYSE") rules relating to investment research activities, LBI entered into consents and agreements with the SEC, the NYSE, the NASD and the Alabama Securities Commission (which acted as LBI' s lead state regulator in connection with the Final Global Settlement) to resolve their investigations of LBI relating to those matters.

Pursuant to the Final Global Settlement, LBI agreed to (i) pay $25 million as a penalty, (ii) pay $25 million as disgorgement of commissions and other monies, (iii) contribute a total of $25 million over five years to provide third-party independent research to clients, (iv) contribute a total of $5 million over five years towards investor education, (v) adopt internal structural and operational reforms that will further augment

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

the steps it has already taken to promote research analyst independence and (vi) be enjoined from the alleged violations of NASD and NYSE rules. In connection with the Final Global Settlement, LBI also voluntarily agreed to adopt restrictions on the allocation of shares in initial public offerings to executives and directors of public companies. LBI has already reached similar arrangements with most of the other states, the District of Columbia and the Commonwealth of Puerto Rico and expects to reach similar arrangements with most or all of the remaining states. Any monetary penalties and other payments required by these individual arrangements are expected to be included within the aggregate amounts discussed above.

In April 2003, to effectuate the Final Global Settlement, the SEC filed a Complaint and Final Judgment in the United States District Court for the Southern District of New York (the "New York District Court"). The Final Judgment was entered by the Court in October 2003. Also in April 2003, the NASD accepted the Letter of Acceptance, Waiver and Consent entered into with LBI in connection with the Final Global Settlement; and in May 2003, the NYSE advised LBI that the Hearing Panel' s Decision, in which it accepted the Final Global Settlement, had become final. Payments have been and will be made in conformance with the payment provisions of the Final Judgment.

Since the announcement of the Final Global Settlement, a number of purported class actions have been filed and are pending against LBI in three federal courts, which are specific to LBI' s research of particular companies (Razorfish, Inc., RealNetworks, Inc., and RSL Communications, Inc.). (*Swack v. Lehman Brothers Inc,* and *Coopersmith, et al. v. Lehman Brothers Inc.*, both in the United States District Court for the District of Massachusetts (Razorfish); *DeMarco v. Lehman Brothers Inc., et al.*, *Sved v. Lehman Brothers Inc., et al.* and *Gravino v. Lehman Brothers Inc., et al.,* all in the New York District Court (RealNetworks); *Fogarazzo v. Lehman Brothers Inc.*, in the New York District Court (RSL Communications)). All the actions allege conflicts of interest between LBI' s investment banking business and research activities and seek to assert claims pursuant to Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder.



In the purported class action relating to RSL Communications, plaintiffs have filed an amended consolidated complaint, containing essentially the same allegations as the original complaints, but adding two other investment banks as defendants. (*Fogarazzo, et al. v. Lehman Brothers Inc., et al.).* The RealNetworks cases also have been consolidated in a single action in the New York District Court, with an amended complaint containing essentially the same allegations as the original complaints (*DeMarco, et al. v. Lehman Brothers Inc.*).

In June 2003, a purported derivative action, *Bader and Yakaitis P.S.P. and Trust, et al. v. Michael L. Ainslie, et al.*, relating to the Final Global Settlement was filed in New York State Supreme Court, New York County. The suit names Holdings and its Board of Directors as defendants and contends that the Board should have been aware of and prevented the alleged misconduct which resulted in the settlement with regulators. In December 2003, plaintiffs filed an amended complaint, reiterating the allegations concerning the alleged failure to detect and prevent conduct resulting in the Final Global Settlement and adding allegations concerning the alleged failure to detect and prevent conduct relating to purportedly improper initial public offering ("IPO") allocation practices, discussed more fully below under the heading *IPO Allocation Cases*.

Also in June 2003, in the Circuit Court of Marshall County, West Virginia, the Attorney General of West Virginia filed a civil action on behalf of the State of West Virginia against LBI and nine other investment banks. The Complaint alleges multiple violations of the West Virginia Consumer Credit and Protection Act ("CCPA") from July 1, 1999 through the present. The Complaint seeks $5,000 in money damages per violation for each and every violation of the CCPA. The specific allegations against LBI are identical to those in the Complaint and Final Judgment that the SEC filed against LBI and the other investment banking firms.

*Actions Regarding Enron Corp.*

*Enron Securities Purchaser Actions.* In April 2002, a Consolidated Complaint for Violation of the Securities Laws was filed in the United States District Court for the Southern District of Texas (the "Texas District Court"), captioned *In re Enron Corporation Securities Litigation* (the "*Enron Litigation*"), alleging claims for violation of Sections 11 and 15 of the Securities Act of 1933 (the "Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and the Texas Securities Act. The case is brought on behalf of a purported class of purchasers of Enron Corporation' s publicly traded equity and debt securities between October 19, 1998 and November 27, 2001, against Holdings and eight other commercial or investment banks, 38 current or former Enron officers and directors, Enron' s accountants, Arthur Andersen LLP ("Andersen") (and affiliated entities and partners) and two law firms. The complaint seeks unspecified compensatory and injunctive relief based on the theory that defendants engaged or participated in manipulative devices to inflate Enron' s reported profits and financial condition, made false or misleading statements, and participated in a scheme or course of business to defraud Enron' s

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

shareholders. In December 2002, the Texas District court granted Holdings' motion to dismiss the Section 10(b) claim. In May 2003, plaintiffs filed an amended complaint against Holdings and LBI, among others, re-asserting claims under Section 10(b) and 20(a) of the Exchange Act (the "Exchange Act claims"). In January 2004, plaintiffs voluntarily withdrew their opposition to Lehman Brothers' motion to dismiss the Exchange Act claims. Given that plaintiffs no longer opposed dismissal of those claims, the Texas District Court entered an order dismissing them on February 4, 2004.

In May 2002, American National Insurance Company ("ANICO") and certain of its affiliates filed a complaint against LBI, Holdings, Lehman Commercial Paper Inc. ("LCPI") and a broker formerly employed by Lehman. The amended complaint, filed in October 2003, is based on allegations similar to those in the *Enron Litigation* and asserts that plaintiffs relied on defendants' allegedly false and misleading statements in purchasing and continuing to hold Enron debt and equities in their LBI accounts. The amended complaint alleges violations of the Texas Securities Act, violations of the Texas Business and Commerce Code, fraud, breach of fiduciary duty, negligence and professional malpractice, and seeks unspecified compensatory relief and punitive damages. This action has been coordinated for pretrial purposes with the *Enron Litigation* in the Texas District Court.

In August 2002, a complaint was filed against Holdings and four other commercial or investment banks, among other defendants, by the Public Employees Retirement System of Ohio and three other state employee retirement plans, containing allegations similar to those in the *Enron Litigation*. Against Holdings, the complaint alleges claims for



common law fraud and deceit, aiding and abetting common law fraud, conspiracy to commit fraud, negligent misrepresentation and violation of the Texas Securities Act, and seeks unspecified compensatory relief and punitive damages. This action has been consolidated with the *Enron Litigation* in the Texas District Court.

In September 2002, the Washington State Investment Board, which is a named plaintiff in the *Enron Litigation*, filed a new purported class action. This action mirrors the *Enron Litigation*, but alleges a longer class action period of September 9, 1997 to October 18, 1998. The amended complaint alleges claims against Holdings and LBI for violations of Sections 11 and 15 of the Securities Act. Plaintiffs seek unspecified compensatory damages, an accounting and disgorgement of certain defendants' alleged insider-trading proceeds, restitution and rescission. This action has been consolidated with the *Enron Litigation* in the Texas District Court.

In October 2002, two actions were filed in Iowa state court (Linn and Polk Counties) against LBI and Holdings, along with several other commercial or investment banks, principally by AUSA Life Insurance Co. and Principal Global Investors, LLC. The complaints allege that defendants participated in, and thus gained knowledge of, the alleged Enron fraudulent scheme by participating in Enron' s debt offerings, making disguised loans to Enron and participating in transactions involving Enron' s special purpose entities ("SPEs"), which were used to avoid recognizing losses, and that defendants failed to disclose that information. The complaints allege violations of the Iowa Securities Act and claims for fraud and deceit and for civil conspiracy. The complaints seek rescission and an unspecified amount of compensatory and punitive damages. LBI and Holdings, along with other commercial or investment banks, have asserted third-party claims for contribution and indemnification in both Iowa actions against Andersen and certain Enron officers.

Also in October 2002, a complaint was filed in Superior Court for Los Angeles County against LBI, Holdings, and other commercial or investment banks by two Oaktree Capital Management investment funds. The complaint, which was amended in June 2003, alleges that Enron systematically falsified its financial statements using improper accounting valuations and false hedges that enabled Enron to boost its reported earnings and that Enron' s bankers, including LBI and Holdings, participated in the fraudulent scheme by engaging in certain transactions with Enron. It also alleges that defendants knew and acted on inside information about Enron' s true financial condition in connection with its offerings of Enron securities, while misrepresenting or omitting material facts to the public. The amended complaint makes claims under California state law for trading on inside information, for making false and misleading statements and for unfair competition by material misstatements or omissions in connection with Enron securities offerings, and seeks unspecified compensatory damages, an accounting, restitution and disgorgement of profits. LBI and Holdings, along with other commercial or investment banks, have asserted third-party claims for contribution and indemnification against Andersen and certain Enron officers.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In April 2003, Westboro Properties LLC and Stonehurst Capital, Inc. filed a complaint against LBI, Holdings and other commercial or investment banks. Plaintiffs allege that defendants engaged in violations of the Texas Securities Act, statutory fraud in stock transactions, fraud, negligence and professional malpractice, and violations Sections 11 and 15 of the 1933 Act in inducing plaintiffs to purchase certain certificates, or investments, in two SPEs, Osprey I and Osprey II. Plaintiffs also allege that defendants aided and abetted Enron' s fraud in setting up SPEs, allegedly falsifying Enron' s books and records and in continuing to recommend Enron' s stock. Plaintiffs seek unspecified actual and special damages, punitive damages and equitable relief. This action has been consolidated with the *Enron Litigation* in the Texas District Court.

In September 2003, a purported class action complaint was filed against Holdings and seven other commercial or investment banks, among other defendants, by Sara McMurray on behalf of purchasers of Enron common stock between October 16, 1998 and November 27, 2001, making the same allegations as the *Enron Litigation*. Plaintiff alleges negligent misrepresentation, common law fraud, breach of fiduciary duty and aiding and abetting breach of fiduciary duty, and seeks unspecified damages for lost investment opportunities and lost benefit of the bargain. This action has been consolidated with the *Enron Litigation* in the Texas District Court.

In December 2003, Connecticut Resources Recovery filed an amended complaint against certain Enron officers and directors, Arthur Andersen and certain individuals associated with Arthur Andersen, law firms, commercial or investment banks, including LBI, Holdings and Holdings' subsidiary LB I Group Inc., and rating agencies. Plaintiff



seeks to recover approximately $200 million in public funds that were allegedly lost when Enron stopped making payments to plaintiff and filed for bankruptcy. The amended complaint makes claims against LBI, Holdings and LB I Group Inc. for aiding and abetting fraudulent misrepresentation, for aiding and abetting negligent misrepresentation and for violation of the Connecticut Unfair Trade Practices Act. Plaintiffs seek compensatory and exemplary damages. This action has been consolidated with the *Enron Litigation* in the Texas District Court.

Also in December 2003, a complaint was filed in the Superior Court for the Judicial District of Hartford, Connecticut, by the Town of New Hartford, Connecticut, individually and on behalf of sixty-nine similarly-situated Connecticut municipalities against the Connecticut Resources Recovery Authority ("CRRA"), the governor of Connecticut, directors of CRRA, various individuals, former officers of Enron and commercial or investment banks, including Holdings. The complaint alleges that plaintiff provided funds to the CRRA, which were then lost when Enron filed for bankruptcy, and that Holdings and other commercial or investment banks participated in Enron' s fraud by assisting Enron in its concealment of its true financial condition, and makes the claims against Holdings for violation of the Connecticut Unfair Trade Practices Act, aiding and abetting fraud, theft or misappropriation, unjust enrichment and fraud. Plaintiff seeks compensatory damages, punitive damages and statutory damages pursuant to CGS § 52-565. Plaintiff has voluntarily dismissed its claims against the banks, including Holdings, but has indicated it intends to reassert them in a new separate action.

In January 2004, a purported class action complaint was filed against Holdings and other commercial or investment banks, among other defendants, by William Young and Frank Conway on behalf of all persons who held Enron shares from April 13, 1999 through November 8, 2001. Making allegations similar to those in the *Enron Litigation*, plaintiffs allege claims for negligent misrepresentation and common law fraud and seek unspecified compensatory damages. This action is currently pending in the Circuit Court of Cook County, Illinois.

*Third-Party Contribution Actions.* In December 2002, Andersen filed a third-party claim for contribution against LBI, Holdings and other commercial or investment banks, as well as a former Enron officer, in an action against Andersen in Oklahoma state court by Samson Investment Co. claiming that Andersen is liable for damages allegedly incurred in connection with certain Enron-related contracts. Plaintiff alleges that Andersen conspired with Enron to misrepresent Enron' s financial condition in its financial statements. Andersen' s third-party petition seeks contribution from LBI and Holdings in the event Andersen is held liable to plaintiff and alleges that LBI, Holdings and other third-party defendants were involved in creating and using Enron' s SPEs, engaged in transactions with the SPEs, misrepresented or failed to disclose to Andersen information about the SPEs, and issued analysts' reports that enhanced the public' s perception of Enron' s financial performance and condition. This action has been coordinated for pretrial purposes with the *Enron Litigation* in the Texas District Court.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In January 2003, Andersen filed a third-party claim for contribution against LBI, Holdings and other commercial or investment banks and one individual in an action against Andersen in Texas state court by Jane Bullock and other purchasers of Enron securities asserting claims for fraud, negligent misrepresentation and civil conspiracy in connection with allegedly materially misleading public statements concerning Enron' s financial condition. Andersen' s third-party petition seeks proportionate liability and contribution from LBI, Holdings and the other third-party defendants. The third-party petition makes similar allegations to those made in the *Samson* case above. After Andersen filed its third-party petition, the court severed certain plaintiffs' claims against Andersen as well as Andersen' s third-party claims into an action captioned *Choucroun v. Arthur Andersen LLP*, which the third-party defendants removed to the Texas District Court. *Choucroun* has been coordinated for pretrial purposes with the *Enron Litigation*.

In February 2003, Andersen filed a third-party petition against LBI, Holdings and other commercial or investment banks and two individuals in an action against Andersen in Texas state court by Al Rajhi Investment Corporation BV asserting claims for fraud and negligent misrepresentation in connection with allegedly materially misleading public statements concerning Enron' s financial condition made in a commodities transaction in which plaintiff allegedly extended $100 million of credit to Enron. The third-party petition seeks the same relief and makes the same allegations as in *Bullock*. This action has been coordinated for pretrial purposes with the *Enron Litigation* in the Texas District Court.

In October 2003, third-party complaints for contribution were filed against LBI, Holdings and other commercial or investment banks by Richard Buy, by Robert Jaedicke and other outside directors, and by Paolo Ferraz Periera,



respectively, in connection with an action filed by ANICO, certain of its affiliates and others alleging that Andersen and certain Enron officers and directors are liable for damages incurred through certain Enron-related investments. This action has been coordinated for pretrial purposes with the *Enron Litigation* in the Texas District Court.

Also in October 2003, third-party claims for contribution were filed by certain Enron officers and outside directors against LBI, Holdings and other commercial or investment banks in four actions, *Ahlich, Delgado, Pearson*, and *Rosen*. The underlying actions in *Ahlich, Delgado Pearson* and *Rosen* are against Andersen, certain of its partners and certain Enron officers and directors and assert that Andersen and some of its partners prepared and disseminated false, misleading and incomplete information about Enron' s financial condition that caused plaintiffs to continue their ownership of Enron securities, and that the Enron officers and directors engaged in SPE transactions to improve Enron' s balance sheet, and reviewed, approved and disseminated the allegedly false and misleading statements on which plaintiffs relied. Except for the third-party claim of Buy in *Ahlich*, the third-party claims against LBI and Holdings in *Ahlich, Delgado* and *Pearson* have been voluntarily dismissed without prejudice. The remaining actions have been coordinated for pretrial purposes with the *Enron Litigation* in the Texas District Court.

*Other Actions.* In August 2002, Capital Management, L.P., the former general partner of LJM2 Co-Investment, L.P., an Enron-related SPE, filed a third-party claim in Delaware Chancery Court alleging that LB I Group Inc., an investor in LJM2, together with the other LJM2 limited partners, breached the LJM2 Limited Partnership Agreement by rescinding a capital call. The claim against LB I Group Inc. and the other limited partners was voluntarily dismissed with prejudice in June 2003.

In August 2003, Al Rajhi Investment Corporation BV filed a petition against rating agencies, law firms, commercial or investment banks, including LBI and Holdings, and others. Plaintiff claims to have engaged in a commodities trade with Enron and to have "effectively extended over $101 million of credit to Enron" in reliance on misrepresentations. The amended complaint alleges that LBI and Holdings were involved in funding LJM2 and the Osprey Trust transactions, that they were involved in Enron transactions used to inflate Enron' s net worth and creditworthiness, and that they made false and misleading statements in analysts' reports. The claims against LBI and Holdings are for conspiracy and for participation in a joint or common enterprise and seek actual and exemplary damages. This action has been coordinated for pretrial purposes with the *Enron Litigation* in the Texas District Court.

In November 2003, a complaint was filed by Enron in the United States Bankruptcy Court for the Southern District of New York (the "New York Bankruptcy Court") against Lehman Brothers Finance S.A. ("LBF"), LBI, Holdings and LCPI. Among other things, the complaint seeks to avoid as preferential transfers and/or fraudulent conveyances approximately $236 million in payments made by Enron in the year

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

prior to Enron' s bankruptcy filing. These payments were made pursuant to transactions under a swap contract between LBF and Enron relating to Enron common stock.

Also in November 2003, Enron filed two nearly identical lawsuits against LCPI, LBIE and other commercial paper dealers and investors in the New York Bankruptcy Court. The complaints allege that monies paid by Enron in October and November 2002 to repurchase its outstanding commercial paper shortly before its maturity were preferential payments and/or fraudulent conveyances under the Bankruptcy Code. Among other things, the complaints seek to avoid and recover these payments from the defendants. In total, approximately $500 million is sought from LCPI and LBIE, nearly all of which relates to LCPI' s role as intermediary between Enron and several co-defendant holders of the commercial paper.

*First Alliance Mortgage Company Matters*

During 1999 and the first quarter of 2000, LCPI provided a warehouse line of credit to First Alliance Mortgage Company ("FAMCO"), a subprime mortgage lender, and LBI underwrote the securitizations of mortgages originated by FAMCO. In March 2000, FAMCO filed for bankruptcy protection in the United States Bankruptcy Court for the Central District of California (the "California Bankruptcy Court"). In August 2001, a purported adversary class action (the "Class Action") was filed in the California Bankruptcy Court, allegedly on behalf of a class of FAMCO borrowers seeking equitable subordination of LCPI' s (among other creditors' ) liens and claims in the California Bankruptcy Court. In October 2001, the complaint was amended to add LBI as a defendant and to add claims for aiding and abetting alleged fraudulent lending activities by FAMCO and for unfair competition under the California Business and



Professions Code. In August 2002, a Second Amended Complaint was filed, which added a claim for punitive damages and extended the class period from May 1, 1996, until FAMCO' s bankruptcy filing. The complaint sought actual and punitive damages, the imposition of a constructive trust on all proceeds paid or being paid by FAMCO to LCPI and LBI, disgorgement of profits and attorneys' fees and costs.

In November 2001, the Official Joint Borrowers Committee (the "Committee") initiated an adversary proceeding, allegedly on behalf of the FAMCO-related debtors, in the California Bankruptcy Court by filing a complaint against LCPI, LBI, Holdings and several individual officers and directors of FAMCO and its affiliates. As to the Lehman defendants, the Committee asserted various bankruptcy claims for avoidance of liens, aiding and abetting and breach of fiduciary duty. In December 2001, the Committee amended its complaint, dropping Holdings as a defendant.

The United States District Court for the Central District of California (the "California District Court") withdrew the reference to the California Bankruptcy Court in both of these cases and in February 2002 consolidated them before the California District Court. In November 2002, the California District Court entered an order defining the class in the Class Action as all persons who acquired mortgage loans from FAMCO from May 1, 1996 through March 31, 2000, which were used as collateral for FAMCO' s warehouse credit line with LCPI or were securitized in transactions underwritten by LBI. In February 2003, the California District Court granted Lehman Brothers' motion for summary judgment on the California Business and Professions Code claims and granting Lehman Brothers' motion for partial summary judgment on the claims prior to 1999 and dismissing those claims. Trial began in February 2003.

In June 2003, the California District Court dismissed plaintiffs' claim for punitive damages. On the same date, the jury rendered its verdict finding LBI and LCPI liable for aiding and abetting FAMCO' s fraud. The jury found damages of $50.9 million and held the Lehman defendants responsible for 10% of those damages. In July 2003, the California District Court entered findings of fact and conclusions of law relating to all claims still pending and holding that any transfers to LCPI were not fraudulent and its liens were not avoidable, nor was equitable subordination of amounts owed by FAMCO to LCPI at the time of the Chapter 11 filing warranted. Judgment was entered in November 2003 on the jury verdict.

In June 2003, the Attorney General of the State of Florida filed a civil complaint against LCPI in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida, alleging violations of the Florida Unfair and Deceptive Trade Practices Act and common law fraud. The allegations arise out of LCPI' s relationship with FAMCO insofar as FAMCO did business with Florida borrowers. The Florida Attorney

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

General alleges in the complaint that, among other things, LCPI provided financing to FAMCO, despite LCPI' s purported knowledge that FAMCO was engaged in "predatory lending" practices. The Complaint seeks a permanent injunction, compensatory and punitive damages, civil penalties, attorney' s fees and costs**.**

*In re Fleming Securities Litigation*

In February 2003, a lawsuit captioned *Massachusetts State Carpenters Pension Fund v. Fleming Companies, Inc., et al*. was filed in the 160th District Court of Dallas County, Texas, asserting claims arising under Sections 11, 12(a) (2), and 15 of the Securities Act of 1933. The action was brought on behalf of a purported class of investors who purchased in two simultaneous Fleming securities offerings in June 2002 that raised approximately $378 million. LBI' s share of these offerings as underwriter was 27.5%. The complaint alleges that the prospectus and registration statement for the offerings contained false and misleading statements or omitted material facts concerning, among other things, deductions Fleming took on vendor invoices, its accounting for recognition of income, amortization of long term assets and use of capitalized interest and the performance of Fleming' s retail operations. The complaint seeks unspecified damages and costs. In addition to Fleming, the suit named as defendants ten officers and/or directors of Fleming, Fleming' s auditor, and the underwriters of the offerings, including LBI.

The case was removed to the United States District Court for the Northern District of Texas. The underwriters are contractually entitled to customary indemnification from Fleming, but subsequent to that removal, in April 2003, Fleming filed for bankruptcy protection. Also in April 2003, plaintiffs filed a virtually identical second lawsuit in the United States District Court for the Eastern District of Texas.



In June 2003, the Judicial Panel on Multidistrict Litigation consolidated certain securities litigations concerning Fleming, to which LBI is not a party, in the United States District Court for the Eastern District of Texas. Subsequently, in September 2003, plaintiffs in the two *Massachusetts State Carpenters Pension Fund* cases to which LBI is a party, and plaintiffs in the consolidated actions, jointly filed a Third Consolidated Amended Class Action Complaint, which, as to LBI, in substance re-alleges the claims set forth in the original *Massachusetts State Carpenters Pension Fund* cases.

*IPO Allocation Cases*

LBI was named as a defendant in approximately 192 purported securities class actions that were filed between March and December 2001 in the New York District Court. The actions, which allege improper IPO allocation practices, were brought by persons who, either directly or in the aftermarket, purchased IPO securities during the period between March 1997 and December 2000. The plaintiffs allege that Lehman and other IPO underwriters required persons receiving allocations of IPO shares to pay excessive commissions on unrelated trades and to purchase shares in the aftermarket at specified escalating prices. The plaintiffs, who seek unspecified compensatory damages, claim that these alleged practices violated various provisions of the federal securities laws, specifically sections 11, 12(a)(2) and 15 of the Securities Act, sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder. The 192 actions in which LBI was named a defendant have been consolidated into 83 cases, each involving a distinct offering. Those 83 consolidated cases, and approximately 226 others in which LBI is not named as a defendant, have been coordinated for pretrial purposes before a single judge.

In January 2002, a separate consolidated class action, entitled *In re Initial Public Offering Antitrust Litigation*, was filed in the New York District Court against LBI, among other underwriters, alleging violations of federal and state antitrust laws. The complaint alleges that the underwriter defendants conspired to require customers who wanted IPO allocations to pay back to the underwriters a percentage of their IPO profits in the form of commissions on unrelated trades, to purchase other, less attractive securities and to buy shares in the aftermarket at predetermined escalating prices. In November 2003, the court dismissed the antitrust action on the grounds that the conduct alleged was impliedly immune from the antitrust laws. Plaintiffs have filed a notice of appeal of that decision to the U.S. Court of Appeals for the Second Circuit.

In April 2002, a suit was filed in Delaware Chancery Court by Breakaway Solutions Inc., which names LBI and two other underwriters as defendants. The complaint purports to be brought on behalf of a class of issuers who issued securities in IPOs through at least one of the defendants during the period January 1998 through October 2000 and whose securities increased in value 15% or more above the original price within 30 days after the IPO. It alleges that defendants underpriced IPO securities and allocated those underpriced securities to certain

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

favored customers in return for alleged arrangements with the customers for increased commissions on other transactions and alleged tie-in arrangements. The complaint asserts claims for breaches of contract, of the implied covenant of good faith and fair dealing and of fiduciary duty, and for indemnification or contribution and unjust enrichment or restitution. Breakaway seeks, among other relief, class certification, injunctive relief, an accounting, declarations requiring defendants to indemnify Breakaway in the pending consolidated IPO securities class actions and determining that Breakaway has no indemnification obligation to defendants in those actions, and compensatory damages.

*Actions Regarding Frank Gruttadauria*

LBI discovered in January 2002 that Frank Gruttadauria, the former branch manager of LBI' s Cleveland office, which was acquired in October 2000 from SG Cowen Securities Corporation as part of the purchase by LBI of certain accounts and related assets belonging to SG Cowen' s private client group, had apparently been involved in creating false account statements for clients of that office and may have caused unauthorized transfers of funds from client accounts. This conduct allegedly took place for a number of years and began well prior to the acquisition of this office by LBI. Under the terms of the purchase agreement, SG Cowen retained liability for activities arising out of the conduct or operation of the business while owned by SG Cowen.

To date, the following cases have been filed against LBI and SG Cowen: Eight cases in the United States District Court for the Northern District of Ohio, six cases in the United States District Court for the Northern District of Illinois, one case in the United States District Court for the Southern District of California, and one case in the United States District



Court for the Eastern District of Wisconsin. One group of plaintiffs that originally filed in the Northern District of Ohio voluntarily stayed the federal court proceeding and filed an NASD arbitration. Another group of plaintiffs originally filing in the Northern District of Ohio has voluntarily stayed the federal court action and has bifurcated their claims in arbitration before the NYSE by filing a claim against LBI in the expedited arbitration process described below, and by filing a separate NYSE arbitration against Holdings. Of the four remaining Northern District of Ohio cases, one is on appeal to the United States Court of Appeals for the Sixth Circuit as a result of the district court' s denial of defendant' s motion to compel arbitration, and the three that remain pending before the district court are subject to motions to compel arbitration.

Two of the cases originally filed in the United States District Court for the Northern District of Illinois have been stayed pending arbitration before the NASD by agreement of the parties, and a third was stayed pending arbitration and subsequently settled. An additional seven arbitrations have been filed including four proceeding in the expedited arbitration process before the NYSE, and three before the NASD. Of these arbitrations, one before the NYSE and one before the NASD have been settled in principle. The case filed in United States District Court for the Southern District of California, four of the cases that had been filed in the United States District Court for the Northern District of Illinois, and one of the cases filed before the NYSE, have been settled. The case pending in the Eastern District of Wisconsin is currently subject to a motion to compel arbitration. A similar motion was previously denied in that matter; however, that decision was reversed by the United States Court of Appeals for the Seventh Circuit.

Generally speaking, the remaining complaints, amended complaints and statements of claim allege violations of federal securities laws, violations of state and "blue sky" laws, civil conspiracy, and common law claims for fraud, promissory estoppel, negligent and reckless failure to supervise and breach of fiduciary duty. On the whole, plaintiffs seek compensatory and punitive damages, pre- and post-judgment interest, attorneys' fees and costs, an accounting and, in some instances, treble damages. One of the NYSE arbitrations is scheduled to go to a hearing in February of 2004, and one of the NASD arbitrations is scheduled to go to a hearing in October 2004.

In August 2003, LBI entered into settlements relating to the Gruttadauria matter with the SEC, the NYSE and the Division of Securities of the Department of Commerce of the State of Ohio (the "Ohio Securities Division"), as follows:

Without admitting or denying any allegations or findings, LBI consented to the entry of an order by the SEC in which the SEC accepted LBI' s Offer of Settlement and found that LBI violated the Exchange Act and rules thereunder in that LBI failed to reasonably supervise Gruttadauria during the 15-month period that LB employed him and failed to maintain complete and accurate books and records. Pursuant to the order,

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

LBI was required to pay $2.5 million, half of which was paid to the U.S. Treasury in August 2003, and half was paid to the NYSE in October 2003. Additionally, Lehman agreed to participate in a special expedited arbitration process for potential claimants.

Without admitting or denying any allegations or findings, LBI also entered into a Stipulation of Facts and Consent to Penalty with the NYSE in which Lehman agreed to (i) a censure; (ii) payment of the $2.5 million as described above; (iii) participate in a special expedited arbitration process for potential claimants; and (iv) undertake a review of certain firm policies, procedures, practices and supervisory systems. In September 2003, the NYSE advised LBI that the Stipulation and Consent had become final.

Without admitting or denying any allegations or findings, LBI agreed to the issuance of an order by the Ohio Securities Division that found that LBI violated certain Ohio regulations relating to supervision and books and records and requiring that LBI promptly file with the Ohio Securities Division a copy of any reports required to be submitted to the SEC and NYSE pursuant to LBI' s settlements with those bodies.

In December 2003, LBI entered into a Non-Prosecution agreement with the Cuyahoga County Prosecutor (the county in which the Cleveland branch was located). The agreement relates to the Prosecutor' s investigation into whether there was any violation of state law by LBI or others in connection with this matter. Pursuant to the agreement, the Company agreed to pay $1.74 million to settle and resolve the issues that were the subject of the investigation.



IPO Fee Litigation

Harold Gillet, et al. v. Goldman Sachs & Co., et al.; Yakov Prager, et al. v. Goldman, Sachs & Co., et al.; David Holzman, et al. v. Goldman, Sachs & Co., et al. Beginning in November 1998, four purported class actions were filed in the New York District Court against in excess of 25 underwriters of IPO securities, including LBI. Plaintiffs, alleged purchasers of securities issued in certain IPOs, seek compensatory and injunctive relief for alleged violations of the antitrust laws based on the theory that the defendants fixed and maintained fees for underwriting certain IPO securities at supra-competitive levels. In February 2001, the New York District Court granted defendants' motion to dismiss the Consolidated Amended Complaint, concluding that the purchaser plaintiffs lacked standing under the antitrust laws to assert the claims. On appeal, the U.S. Court of Appeals for the Second Circuit reversed and remanded the case to the New York District Court for further proceedings, including potential dismissal of the claims based on additional arguments raised in the motion to dismiss.

In Re Issuer Plaintiff Initial Public Offering Fee Antitrust Litigation. In April 2001, the New York District Court consolidated four actions pending before the court brought by bankrupt issuers of IPO securities against more than 20 underwriter defendants (including LBI). In July 2001, the plaintiffs filed a consolidated class action complaint seeking unspecified compensatory damages and injunctive relief for alleged violations of the antitrust laws based on the theory that the defendant underwriters fixed and maintained fees for underwriting certain IPO securities at supra-competitive levels. Two of the four original plaintiffs subsequently withdrew their claims.

Island Venture Corporation, et al. v. Lehman Brothers Inc. and Lehman Brothers Securities Asia, Ltd.

In February 2001, Island Venture Corporation, Continental Resources Corporation, Recola Investment Corporation, Grand Concord Corporation and Goodwell Industrial Corporation filed a First Amended Complaint in the United States District Court for the District of New Jersey against LBI and Lehman Brothers Securities Asia Limited. In July 2001, plaintiffs filed a Second Amended Complaint. The complaint arises in connection with the plaintiffs' purchase of various promissory notes issued by Indonesian companies in 1997 and upon which the issuers have defaulted. It also asserts claims relating to an alleged unauthorized liquidation for $8.5 million of a $10 million Asia Investment Grade Default Note ( ' 'Basket Note' ' ) issued by Lehman Brothers Holdings Plc. The complaint seeks rescission and damages under various common law theories of mutual mistake, breach of contract, breach of fiduciary duty, negligence, negligent misrepresentation and constructive fraud, as well as asserting claims under Section 10(b) of the Exchange Act. The plaintiffs seek to recover damages of approximately $60 million on all the notes they purchased and the difference between the liquidation price and the face value of the Basket Note plus lost interest payments. In December 2003, the parties agreed to a settlement of this matter, and it was dismissed.

Juan Pablo Rodriguez, et al v. Lehman Brothers Inc.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In October 2003, LBI was served with a Statement of Claim in arbitration before the NASD, in which the claimants allege that unsuitable trades recommended by Lehman Brothers led to investment losses of approximately $60 million in the claimants' account. Additional causes of action set forth in the Statement of Claim include churning, SEC rule and federal and state statute violations, breach of contract, breach of fiduciary duty, common law fraud, negligent supervision, negligence and gross negligence.

Metricom Securities Litigation

In August 2002, an amended complaint was filed in the United States District Court for the Northern District of California captioned In re Metricom Securities Litigation. The action is brought on behalf of a purported class of investors who purchased the common stock of Metricom, Inc., during the period from June 21, 1999, to July 2, 2001. Plaintiffs name various officers, directors and selling shareholders of Metricom, along with LBI as lead underwriter and the four other co-managing underwriters of an offering of Metricom common stock in February 2000. The underwriters are contractually entitled to customary indemnification from Metricom in connection with the offering, but prior to the commencement of this action, Metricom filed for bankruptcy protection. The February 2000 offering raised approximately $500 million, of which Lehman' s underwriting share was 28.5%. Against the underwriters, plaintiffs allege violations of Sections 11 and 12(2) of the Securities Act and of Section 10(b) of the



Exchange Act. The complaint alleges that the prospectus and registration statement for the offering failed to disclose material facts concerning, among other things, Metricom' s flawed business plan and marketing strategy. The complaint seeks class action status, unspecified damages and costs.

In May 2003 the court dismissed that complaint. In July 2003, plaintiffs filed a second amended complaint that drops claims against the underwriters under the Exchange Act but realleges claims against them under the Securities Act.

*Mirant Securities Litigation*

In November 2002, an amended complaint was filed in the United States District Court for the Northern District of Georgia, Atlanta Division, captioned *In re Mirant Corporation Securities Litigation*. The action is brought on behalf of a purported class of investors who purchased the securities of Mirant Corporation during the period from September 26, 2000 and September 5, 2002. Plaintiffs name Mirant, various officers and directors, Mirant' s former parent, The Southern Company, along with its officers and directors, LBI, as a member of the underwriting syndicate, and eleven other underwriters of Mirant' s IPO of common stock in September 2000. The underwriters are contractually entitled to customary indemnification from Mirant, but Mirant filed for bankruptcy protection in July 2003. The IPO raised approximately $1.467 billion, of which Lehman' s underwriting share was 9%. Against the underwriters, plaintiffs allege violations of Section 11 of the Securities Act. The complaint alleges that the prospectus and registration statement for the offering contained false and misleading statements or failed to disclose material facts concerning, among other things, Mirant' s alleged misconduct in energy markets in the State of California, the accounting for Mirant' s interest in a United Kingdom-based company, Western Power Distribution, and other accounting issues. The complaint seeks class action certification, unspecified damages and costs. In November 2003, the Court overseeing the Mirant bankruptcy stayed the litigation for at least six months.

*WorldCom Litigation*

LBI and other underwriters of WorldCom, Inc. bonds in several offerings issued in 1997, 1998, 2000 and 2001 (the "Offerings") have been named as defendants in multiple lawsuits alleging that the offering materials were false and misleading. Most of these actions also name as defendants WorldCom' s present or former officers and/or directors and/or WorldCom' s outside accounting firm. LBI underwrote $915 million principal amount of bonds in the 1998 Offering of a total of $6.1 billion and $375 million principal amount of bonds in the 2000 Offering of a total of $5 billion. (LBI did not participate in the 1997 and 2001 Offerings nor in a December 2000 private placement which is also the subject of certain lawsuits.) The underwriters are contractually entitled to customary indemnification from WorldCom in connection with the various offerings, but WorldCom has filed for bankruptcy protection.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

*In re WorldCom Inc. Securities Litigation* is the result of the consolidation of cases commenced in and/or transferred to the New York District Court. In October 2003 it was certified as a class action, on behalf of investors who allegedly purchased or acquired WorldCom securities between April 29, 1999 and June 25, 2002, including notes issued in the 2000 Offering and 2001 Offering. The consolidated action alleges violations of Section 11 and Section 12(a)(2) of the Securities Act against the underwriters. A corrected amended complaint was filed in December 2003. Plaintiffs seek unspecified compensatory damages, among other things. The deadline for class members to opt-out of the class is February 20, 2004. A trial date has been set for January 2005.

*Individual Actions*. In addition to the class action, 53 individual actions asserting federal securities claims and/or state and common law claims based on the Offerings have also been filed naming LBI and/or Holdings as a defendant. Plaintiffs in these actions seek, among other things, rescission, compensatory and/or punitive damages and generally assert claims under Section 11 of the Securities Act, and in some instances, state common law. Most of these actions were filed in state courts but were removed to federal court as "related to" WorldCom' s bankruptcy. With the exception of the remanded actions listed below, each of these actions has been or is expected to be transferred to the New York District Court by the Judicial Panel for Multidistrict Litigation for consolidated pre-trial proceedings with the class action discussed above.

In January 2004, the Second Circuit Court of Appeals agreed to hear an appeal of whether certain of these actions



should be remanded to the state courts.

In November 2003, the New York District Court issued an order in one of the individual actions (*State of Alaska Dep' t of Revenue v. Citigroup, Inc.*) dismissing as time-barred Securities Act claims brought after June 2003 (one year after WorldCom announced its need for a restatement of its financials) and before the October 24, 2003 decision certifying the class; Securities Act claims based on the 1998 Offering and a December 2000 private placement; and dismissing all claims against underwriter and director defendants added by amendment after June 2003. The New York District Court requested that defendants file motions to dismiss other claims and/or actions pursuant to the November order, and they have done so in each case described below where such motion would be appropriate. The New York District Court granted these motions but qualified the decision with another ruling that permits an individual action plaintiff to voluntarily dismiss his or her action on the condition that he or she pursue only class action claims as a member of the class.

The following individual actions, which asserted Securities Act claims and/or state and common law claims, have been commenced against LBI and/or Holdings in state court, removed and transferred to the New York District Court:

An action was commenced in October 2002 and amended in July 2003 in the Supreme Court of the State of New York, New York County, by municipal pension funds which allegedly purchased WorldCom common stock and WorldCom bonds in the principal amount of $383 million, an unspecified amount of which are alleged to be traceable to the 2000 Offering and 2001 Offering.

Two actions were commenced in the Washington Superior Court, Kings County by a state pension fund which allegedly purchased WorldCom bonds issued in the 1998 and 2001 Offerings and the 2000 Private Placement in the principal amount of approximately $162 million.

Three lawsuits were filed in November 2002 and January 2003, and were amended in July 2003, in the Superior Court of California, Los Angeles County, by county, municipal and private pension and retirement funds that allegedly purchased, respectively, approximately $157 million, $102 million and $135 million principal amount of WorldCom bonds issued in the 1998, 2000 and 2001 public offerings and a December 2000 private offering.

Two suits were filed in December 2002 in the Wisconsin Circuit Court, Dane County, and in the State of Minnesota District Court, Second Judicial District, by state and municipal pension funds, which allegedly purchased a total of approximately $133 million and $161 million, respectively, of WorldCom bonds issued in the 1998, 2000 and 2001 public offerings.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

An action commenced in April 2003 and amended in September 2003 in the Superior Court of Alaska, First Judicial District at Juneau, was brought by a state agency which allegedly purchased WorldCom bonds issued in the 1998 Offering, 2000 Offering, 2000 Private Placement and 2001 Offering in the principal amount of $62.6 million. On November 21, the New York District Court granted defendants' motions to dismiss in part (as explained above).

An action commenced in April 2003 in the Superior Court of California, Orange County was brought by two financial institutions which allegedly purchased or retained artificially inflated WorldCom bonds issued in the 2000 Offering, 2001 Offering and other bond offerings. Plaintiffs allege purchases in the principal amount of $34.2 million.

An action commenced in April 2003 and amended in September 2003 in the Circuit Court of Michigan, Wayne County was brought by municipal retirement systems which allegedly purchased WorldCom bonds issued in the 2000 Offering and 2001 Offering in the principal amount of $45.8 million.

An action commenced in May 2003 and amended in September 2003 in the Superior Court of Maine, Kennebec County was brought by a state retirement system which allegedly purchased WorldCom bonds issued in the 1998 Offering, 2000 Offering and 2001 Offering in the principal amount of $103 million.



An action commenced in May 2003 in the Circuit Court of Wisconsin, Milwaukee County was brought by an insurance company which allegedly purchased WorldCom bonds issued in the 1998 Offering, 2000 Offering and 2001 Offering in the principal amount of $508.5 million

An action commenced in June 2003 and amended in October 2003 in the Superior Court of California, San Francisco County was brought by an institution which allegedly purchased WorldCom bonds issued in the 1998 Offering, 2000 Offering and 2001 Offering in the principal amount of $158.6 million.

An action commenced in June 2003 in the District Court of Texas, Dallas County was brought by a financial institution which allegedly purchased WorldCom bonds issued in the 1998 Offering, 2000 Offering, 2000 Private Placement and 2001 Offering in the principal amount of $303.4 million.

An action was commenced in November 2003 in the Southern District of Mississippi was conditionally transferred to the New York District Court by the Judicial Panel on Multidistrict Litigation. This action was brought by a non-profit corporation which allegedly purchased WorldCom bonds issued in the 1997 Offering, 1998 Offering, 2000 Offering and 2001 Offering. It alleges losses of $65 million for debt and equity claims.

Actions originally commenced in Illinois, California and Ohio state courts which are pending in the New York District Court were amended in July 2003 to assert claims against LBI and Holdings, among others. Plaintiffs in the Illinois and California actions commenced in July 2002 allegedly purchased WorldCom bonds totaling approximately $111 million and $1.160 billion respectively and plaintiffs in the Ohio action, commenced in September 2002, assert losses in excess of $400 million in connection with the 1998 Offering, 2000 Offering, 2001 Offering and a December 2000 private placement.

In addition, actions have been filed in federal court in Mississippi by a bank and trust company, in New York by investment funds and by state or union pension funds in state courts (which were subsequently removed) in Ohio (2), Montana, Maryland (2), New Jersey, California (2), District of Columbia (2), Idaho, Alaska (2) and Illinois (3) and in actions originally commenced by state pension funds in Illinois state court which have been amended in July 2003 while pending before the New York District Court to include LBI and Holdings as defendants; each, insofar as LBI is concerned, assert damages of less than $15 million.

Finally, fifteen actions were commenced in various Mississippi state courts between December 2002 and May 2003 by individual investors who assert claims based on various WorldCom bond offerings but who do not allege the purchase of any bonds. The New York District Court in December2003 granted these plaintiffs' motions to file amended complaints.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

*Remanded Actions*. A lawsuit was filed in January 2003 in the Chancery Court of Davidson County in Tennessee on behalf of the Tennessee Consolidated Retirement System, which allegedly purchased $60 million principal amount of WorldCom bonds issued in the 1998 and 2000 offerings (as well as $102 million in the 2001 offerings in which Lehman did not participate). The complaint alleges violations of Section 11 of the Securities Act against LBI and Holdings. This action was removed to the U.S. District Court for the Middle District of Tennessee; the federal district court issued a decision remanding the action to state court but stayed the remand to allow an appeal. No appeal decision has yet been rendered.

An action brought in Illinois Circuit Court, Madison County, by a municipal retirement system which purchased approximately $62,000,000 principal amount of WorldCom bonds issued in 1998, 2000 and 2001 offerings and a December 2000 private placement. This action, which alleges violations of the Securities Act, was removed to the U.S. District Court for the Southern District of Illinois; the district court remanded the action to state court. The underwriters have filed an appeal of the remand to the United States Court of Appeals for the Seventh Circuit. Plaintiff seeks rescission or damages, among other things.

Actions commenced by state or union pension funds have been remanded to state courts in Pennsylvania (three actions) and Alabama; each, insofar as LBI is concerned, allege violations of disclosure requirements and assert damages of less than $15 million. The underwriters have filed preliminary objections in the Pennsylvania actions



and a motion to dismiss in the Alabama action.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

# PART II

## ITEM 5. MARKET FOR REGISTRANT' S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The approximate number of holders of record of the Registrant' s Common Stock was 22,700 at February 13, 2004. Information concerning the market for the Registrant' s common equity, dividends and related stockholder matters is set forth under the captions "Selected Financial Data" and "Other Stockholder Information" in the 2003 Annual Report, and is incorporated herein by reference.

## ITEM 6. SELECTED FINANCIAL DATA

The information under the captions "Selected Financial Data" and "Management' s Discussion and Analysis−Certain Factors Affecting Results of Operations" contained in the 2003 Annual Report and the information under "Item 1−Business−Forward-Looking Statements" in this Report is incorporated herein by reference.

## ITEM 7. MANAGEMENT' S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management' s Discussion and Analysis of Financial Condition and Results of Operations is set forth under the caption "Management' s Discussion and Analysis" in the 2003 Annual Report. Such information is incorporated herein by reference and should be read in conjunction with the Consolidated Financial Statements and the Notes thereto contained in the 2003 Annual Report.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information under the caption "Management' s Discussion and Analysis−Risk Management" in the 2003 Annual Report is incorporated herein by reference.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Consolidated Financial Statements of the Registrant and its Subsidiaries together with the Notes thereto and the Report of Independent Auditors thereon required by this Item are contained in the 2003 Annual Report and are incorporated herein by reference. Condensed unconsolidated financial information of Holdings and notes thereto are set forth in Schedule I beginning on Page F-2 of this Report and are incorporated herein by reference.

Holdings has issued a full and unconditional guaranty of certain outstanding and future debt securities of its wholly-owned subsidiary, LBI. Condensed consolidating financial information pursuant to Rule 3-10(c) of Regulation S-X is set forth in Note 9 in Schedule I in this Report.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.



**ITEM 9A. CONTROLS AND PROCEDURES**

Management of the Company, with the participation of the Chairman and Chief Executive Officer and the Chief Financial Officer of Holdings (its principal executive officer and principal financial officer, respectively), evaluated the Company' s disclosure controls and procedures as of the end of the fiscal year covered by this Report.

Based on that evaluation, the Chairman and Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the fiscal year covered by this Report, the Company' s disclosure controls and procedures are effective to ensure that information required to be disclosed by Holdings in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC' s rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by Holdings in such reports is accumulated and communicated to the Company' s management, including the Chairman and Chief Executive Officer and the Chief Financial Officer of Holdings, as appropriate to allow timely decisions regarding required disclosure.

There was no change in the Company' s internal control over financial reporting that occurred during the Registrant' s fourth fiscal quarter of 2003 that has materially affected, or is reasonably likely to materially affect, the Company' s internal control over financial reporting.

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information relating to Directors of the Registrant is set forth under the captions "Nominees for Election as Class II Directors to Serve until the 2007 Annual Meeting of Stockholders," "Class I Directors Whose Terms Continue until the 2005 Annual Meeting of Stockholders," "Class III Directors Whose Terms Continue until the 2006 Annual Meeting of Stockholders," "Committees of the Board of Directors−Audit Committee" and "−Nominating and Corporate Governance Committee" and "Other Matters−Procedures for Recommending Director Candidates to the Nominating and Corporate Governance Committee" in the Proxy Statement, and information relating to Executive Officers of the Registrant is set forth under the caption "Executive Officers of the Company" in the Proxy Statement, and is incorporated herein by reference.

Information relating to beneficial ownership reporting compliance by Directors and executive officers of the Registrant pursuant to Section 16(a) of the Exchange Act is set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement, and is incorporated herein by reference.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company has a Code of Ethics which is applicable to all Directors, officers and employees of the Company, including the Chairman and Chief Executive Officer and the Chief Financial Officer of Holdings (its principal executive officer and principal financial and accounting officer, respectively). The Code of Ethics is available on the Corporate Governance page of the Company' s web site at www.lehman.com/shareholder/corpgov. A copy of the Code of Ethics will be provided without charge to any person who requests it by writing to the address or telephoning the number indicated under "Available Information" on page 2. The Company will disclose on its web site amendments to or waivers from its Code of Ethics applicable to Directors or executive officers of Holdings, including the Chairman and Chief Executive Officer and the Chief Financial Officer, in accordance with all applicable laws and regulations.

## ITEM 11. EXECUTIVE COMPENSATION

Information relating to executive compensation is set forth under the captions "Compensation of Directors," "Compensation Committee Report on Executive Officer Compensation," "Compensation and Benefits Committee Interlocks and Insider Participation," "Compensation of Executive Officers" and "Performance Graph" in the Proxy Statement and is incorporated herein by reference.



## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information relating to security ownership of certain beneficial owners and management is set forth under the captions "Security Ownership of Principal Stockholders" and "Security Ownership of Directors and Executive Officers" in the Proxy Statement and is incorporated herein by reference.

The following table sets forth certain information as of November 30, 2003, regarding shares of common stock of Holdings authorized for issuance under equity compensation plans:

| Plan Category | Number of securities to be issued upon exercise of outstanding options, warrants and rights (1) | Weighted-average exercise price of outstanding options, warrants and rights (1) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column) (2) |
|---|---|---|---|
| Equity compensation plans approved by security holders (3) | 12.9 million | $ 46.27 | 11.9 million |
| Equity compensation plans not approved by security holders (4) | 73.9 million | $ 50.90 | 42.6 million |
| Total | 86.8 million | $ 50.21 | 54.5 million |

(1) These columns do not include shares of restricted stock and restricted stock units ("RSUs"), which by their nature do not have an exercise price. In addition to shares of Holdings common stock to be issued upon the exercise of outstanding options and other rights, at November 30, 2003, there were shares of restricted stock and RSUs outstanding under the following plans:

Approved by the shareholders of Holdings:

| | |
|---|---|
| Lehman Brothers 1994 Management Ownership Plan | 1.0 million RSUs |
| Lehman Brothers 1996 Management Ownership Plan | 6.3 million RSUs |

Not approved by the shareholders of Holdings:

| | |
|---|---|
| Lehman Brothers Employee Incentive Plan (the "EIP") | 55.3 million RSUs |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| 1999 Neuberger Berman Inc. Long-term Incentive Plan (the "Neuberger LTIP") | 2.4 million restricted shares and RSUs |
| Neuberger Berman Wealth Accumulation Plan (the "Neuberger WAP") | 0.2 million restricted shares |

In connection with the Company' s acquisition of Neuberger Berman in October 2003, the Company assumed Neuberger' s obligations under the last two plans named above and the Neuberger DSIP (as defined below). The Neuberger LTIP had been approved by Neuberger Berman' s shareholders.

Where feasible, based on market conditions and other factors, shares of common stock are repurchased in the market to offset the future delivery requirements associated with options and RSUs. As of February 13, 2004, approximately 43,458,800 million shares have been repurchased by the Company with respect to outstanding awards and are held in the 1997 Trust Under Lehman Brothers Holdings Inc. Incentive Plans.

(2) The various equity compensation plans provide for purchase of unrestricted stock and for issuance of awards in the form of options, performance stock units ("PSUs"), restricted stock, RSUs and/or other types of equity awards up to an aggregate maximum number of shares for each plan. Therefore the number of shares remaining available for future issuance shown in this column includes not only options, warrants and other rights but also restricted stock, RSUs, PSUs and unrestricted stock, as further described below.

(3) Common stock to be issued under equity compensation plans approved by security holders consists of options issued under the 1994 Management Ownership Plan and the 1996 Management Ownership Plan. As of November 30, 2003, there were remaining available for future issuance 2.1 million shares under the 1994 Management Ownership Plan and 3.9 million



shares under the 1996 Management Ownership Plan (which, in both cases, may be issued as options, PSUs, RSUs and/or other types of equity awards) and 5.9 million shares under the Lehman Brothers Employee Stock Purchase Plan (the "ESPP") (which are purchased as unrestricted stock). The ESPP is a broadly-based plan, qualified under Section 423 of the Internal Revenue Code. The ESPP expires in June 2004, and the Company currently does not intend to renew it.

(4) Common stock to be issued under equity compensation plans not approved by security holders consists of options issued under the Lehman Brothers Employee Incentive Plan (the "EIP"), the Neuberger LTIP, the Neuberger WAP and the 1999 Neuberger Berman Directors Stock Incentive Plan (the "Neuberger DSIP"). Shareholder approval was not required for the EIP under the then current rules of the New York Stock Exchange because it is a broadly-based plan, as a majority of the Firm' s full-time U.S. employees are eligible for awards under the plan and a majority of the awards during any three-year period are to employees who are not officers or directors. As of November 30, 2003, there were 41.5 million shares remaining available for future issuance under the EIP, 1.1 million shares available under the Neuberger LTIP, no shares available under the Neuberger WAP, and no shares available under the Neuberger DSIP. (The shares that remain available under the foregoing plans may be issued as options, PSUs or RSUs, restricted stock and/or other types of equity awards) .

Descriptions of the 1994 Management Ownership Plan, the 1996 Management Ownership Plan, the ESPP, the EIP the Neuberger LTIP, the Neuberger WAP and the Neuberger DSIP are contained in Note 15 of the Notes to Consolidated Financial Statements in the 2003 Annual Report and are incorporated herein by reference.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information relating to certain relationships and related transactions is set forth under the caption "Certain Transactions and Agreements with Directors and Executive Officers" in the Proxy Statement and is incorporated herein by reference.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Information relating to fees paid to the Company' s independent auditors and certain related matters is set forth under the caption "Ernst & Young LLP Fees and Services" in the Proxy Statement and is incorporated herein by reference.



## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) 1. Financial Statements:

The Financial Statements and the Notes thereto and the Report of Independent Auditors thereon incorporated by reference herein and filed as an exhibit hereto are listed on page F-1 hereof by reference to the corresponding page numbers in the 2003 Annual Report.

2. Financial Statement Schedules:

The financial statement schedule and the notes thereto filed as a part hereof are listed on page F-1 hereof.

3. Exhibits:

| Exhibit No. | |
|---|---|
| 2.01 | Agreement and Plan of Merger, dated as of July 21, 2003, as amended by the First Amendment to Agreement and Plan of Merger, dated as of September 22, 2003, among the Registrant, Ruby Acquisition Company and Neuberger Berman Inc. (incorporated by reference to Exhibit 2.1 to Amendment No. 3 to the Registrant' s Registration Statement on Form S-4 (Reg. No. 333-108025) filed with the SEC on October 1, 2003) |
| 2.02 | Voting Agreement, dated as of July 21, 2003, among the Registrant and the stockholders of Neuberger Berman Inc. signatory thereto (incorporated by reference to Exhibit 2.2 to the Registrant' s Current Report on Form 8-K filed with the SEC on July 22, 2003) |
| 3.01 | Restated Certificate of Incorporation of the Registrant dated May 27, 1994 (incorporated by reference to Exhibit 3.1 to the Registrant' s Transition Report on Form 10-K for the eleven months ended November 30, 1994) |
| 3.02 | Certificate of Designations with respect to the Registrant' s 5.94% Cumulative Preferred Stock, Series C (incorporated by reference to Exhibit 4.1 to the Registrant' s Current Report on Form 8-K filed with the SEC on May 13, 1998) |
| 3.03 | Certificate of Designations with respect to the Registrant' s 5.67% Cumulative Preferred Stock, Series D (incorporated by reference to Exhibit 4.2 to the Registrant' s Current Report on Form 8-K filed with the SEC on July 23, 1998) |
| 3.04 | Certificate of Designations with respect to the Registrant' s Fixed/Adjustable Rate Cumulative Preferred Stock, Series E (incorporated by reference to Exhibit 4.2 to the Registrant' s Current Report on Form 8-K filed with the SEC on March 30, 2000) |
| 3.05 | Certificate of Amendment of the Restated Certificate of Incorporation of the Registrant, dated April 9, 2001 (incorporated by reference to Exhibit 3.5 to the Registrant' s Quarterly Report on Form 10-Q for the quarter ended February 28, 2001) |
| 3.06 | Certificate of Designations with respect to the Registrant' s 6.50% Cumulative Preferred Stock, Series F (incorporated by reference to Exhibit 4.01 to the Registrant' s Current Report on Form 8-K filed with the SEC on August 26, 2003) |
| 3.07 | Certificate of Designations with respect to the Registrant' s Floating Rate Cumulative Preferred Stock, Series G (incorporated by reference to Exhibit 4.1 to the Registrant' s Current Report on Form 8-K filed with the SEC on January 30, 2004) |
| 3.08 | By-Laws of the Registrant, amended as of October 22, 2002 (incorporated by reference to Exhibit 3.06 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2002) |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| 4.01 | Standard multiple series indenture provisions with respect to the senior and subordinated debt securities (incorporated by reference to Exhibit 4(a) to Post-Effective Amendment No. 1 to the Registrant' s Registration Statement on Form S-3 (Reg. No. 33-16141)) |



| | |
|---|---|
| 4.02 | Indenture with respect to senior debt securities (incorporated by reference to Exhibit 4(b to Post-Effective Amendment No. 1 to the Registrant' s Registration Statement on Form S-3 (Reg. No. 33-16141)) |
| 4.03 | First Supplemental Indenture with respect to senior debt securities (incorporated by reference to Exhibit 4(m) to the Registrant' s Registration Statement on Form S-3 (Reg. No. 33-25797)) |
| 4.04 | Second Supplemental Indenture with respect to senior debt securities (incorporated by reference to Exhibit 4(e) to the Registrant' s Registration Statement on Form S-3 (Reg. No. 33-49062)) |
| 4.05 | Third Supplemental Indenture with respect to senior debt securities (incorporated by reference to Exhibit 4(f )to the Registrant' s Registration Statement on Form S-3 (Reg. No. 33-46146)) |
| 4.06 | Fourth Supplemental Indenture with respect to senior debt securities (incorporated by reference to Exhibit 4(f) to Registrant' s Registration Statement on Form 8-A filed with the SEC on October 7, 1993) |
| 4.07 | Fifth Supplemental Indenture with respect to the senior debt securities (incorporated by reference to Exhibit 4(h) to Post-Effective Amendment No. 1 to the Registrant' s Registration Statement on Form S-3 (Reg. No. 33-56615)) |
| 4.08 | Sixth Supplemental Indenture with respect to the senior debt securities (incorporated by reference to Exhibit 4(h) to the Registrant' s Registration Statement on Form S-3 (No. 333-38227)) |
| | *The other instruments defining the rights of holders of the long-term debt securities of the Registrant and its subsidiaries are omitted pursuant to section (b)(4)(iii)(A) of Item 601 of Regulation S-K. The Registrant hereby agrees to furnish copies of these instruments to the Securities and Exchange Commission upon request.* |
| 10.01 | Tax Allocation Agreement between Shearson Lehman Brothers Holdings Inc. and American Express Company (incorporated by reference to Exhibit 10.2 to the Registrant' s Transition Report on Form 10-K for the eleven months ended November 30, 1994) |
| 10.02 † | Lehman Brothers Inc. Executive and Select Employees Plan (incorporated by reference to Exhibit 10.4 to the Registrant' s Registration Statement on Form S-1 (Reg. No. 33-12976)) |
| 10.03 † | Lehman Brothers Holdings Inc. Deferred Compensation Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.11 to the Registrant' s Registration Statement on Form S-1 (Reg. No. 33-12976)) |
| 10.04 | Amended and Restated Agreements of Limited Partnership of Shearson Lehman Hutton Capital Partners II (incorporated by reference to Exhibit 10.48 to the Registrant' s Annual Report on Form 10-K for the year ended December 31, 1988) |
| 10.05 † | Lehman Brothers Holdings Inc. 1994 Management Ownership Plan, as amended through November 19, 2002 (incorporated by reference to Exhibit 10.05 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2002) |
| 10.06 † | Lehman Brothers Holdings Inc. 1996 Management Ownership Plan, as amended through November 19, 2002 (incorporated by reference to Exhibit 10.06 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2002) |
| 10.07 † | Lehman Brothers Holdings Inc. Short-Term Executive Compensation Plan, as amended through February 19, 2003 (incorporated by reference to Exhibit 10.07 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2002) |
| 10.08 † | Amended and Restated Lehman Brothers Holdings Inc. Employee Incentive Plan, as amended through February 19, 2003 (incorporated by reference to Exhibit 10.08 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2002) |
| 10.09 † | Lehman Brothers Holdings Inc. Cash Award Plan, as amended (incorporated by reference to Exhibit 10.09 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2002) |
| 10.10 | Amended and Restated Agreement of Limited Partnership of Lehman Brothers Capital Partners III, L.P. (incorporated by reference to Exhibit 10.27 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 1995) |
| 10.11 | Agreement of Limited Partnership of Lehman Brothers Capital Partners IV, L.P. (incorporated by reference to Exhibit 10.30 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 1997) |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| 10.12*† | Lehman Brothers Supplemental Retirement Plan, as amended through December 10, 2003 |



| | |
|---|---|
| 10.13 | Purchase and Sale Agreement dated as of October 19, 2001, between MSDW 745, LLC, as seller, and LB 745 LLC, as purchaser (incorporated by reference to Exhibit 10.15 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2001) |
| 10.14 | Amendment to Purchase and Sale Agreement dated as of the October 19, 2001, between MSDW 745, LLC, as seller, and LB 745 LLC, as purchaser (incorporated by reference to Exhibit 10.16 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2001) |
| 10.15 | JV Option Agreement dated November 19, 1998, between Rock-Forty-Ninth LLC and LB 745 LLC (as assignee of MSDW 745, LLC (incorporated by reference to Exhibit 10.17 to the Registrant' s Annual Report on Form 10-K for the fiscal year ended November 30, 2001) |
| 10.16 † | 1999 Neuberger Berman Inc. Directors Stock Incentive Plan (incorporated by reference to Exhibit 10.1 to Neuberger Berman Inc.' s Registration Statement on Form S-1 (Reg. No. 333-84525)) |
| 10.17 † | Amendment No. 1 to the 1999 Neuberger Berman Inc. Directors Stock Incentive Plan (incorporated by reference to Exhibit 10.17 to Neuberger Berman Inc.' s Annual Report on Form 10-K, for the year ended December 31, 2000) |
| 10.18 † | 1999 Neuberger Berman Inc. Long-Term Incentive Plan (incorporated by reference to Exhibit 10.2 to Neuberger Berman Inc.' s Registration Statement on Form S-1 (Reg. No. 333-84525)) |
| 10.19 † | Amendment No. 1 to the 1999 Neuberger Berman Inc. Long-Term Incentive Plan (incorporated by reference to Exhibit 10.18 to Neuberger Berman Inc.' s Annual Report on Form 10-K, for the year ended December 31, 2000) |
| 10.20 † | Neuberger Berman Inc. Wealth Accumulation Plan, Amended and Restated as of September 1, 2000 (incorporated by reference to Exhibit 10.21 to Neuberger Berman Inc.' s Annual Report on Form 10-K, for the year ended December 31, 2000) |
| 10.21 † | Neuberger Berman Inc. Employee Stock Purchase Plan, Amended and Restated as of September 1, 2000 (incorporated by reference to Exhibit 10.22 to Neuberger Berman Inc.' s Annual Report on Form 10-K, for the year ended December 31, 2000) |
| 12.01* | Computations in support of ratio of earnings to fixed charges and ratio of earnings to combined fixed charges and preferred stock dividends |
| 13.01* | The following portions of the Company' s 2003 Annual Report to Stockholders, which are incorporated by reference herein: "Management' s Discussion and Analysis," "Report of Independent Auditors," "Consolidated Financial Statements," "Notes to Consolidated Financial Statements," "Selected Financial Data" and "Other Stockholder Information" on pages 32 − 108. |
| 21.01* | List of the Registrant' s Subsidiaries |
| 23.01* | Consent of Ernst & Young LLP |
| 24.01* | Powers of Attorney |
| 31.01* | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and 15d-14(a) |
| 31.02* | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and 15d-14(a) |
| 32.01* | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Enacted by Section 906 of the Sarbanes-Oxley Act of 2002 (This certification is being furnished in accordance with the Sarbanes-Oxley Act of 2002 and Commission Release No. 34-47551 and shall not be deemed "filed" with the Commission for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Registrant specifically incorporates it by reference.) |
| 32.02* | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Enacted by Section 906 of the Sarbanes-Oxley Act of 2002 (This certification is being furnished in accordance with the Sarbanes-Oxley Act of 2002 and Commission Release No. 34-47551 and shall not be deemed "filed" with the Commission for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Registrant specifically incorporates it by reference.) |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

* Filed/furnished herewith

† Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K pursuant to Item 15(c) of Form 10-K



(b) The following Current Reports on Form 8-K were filed during the Registrant' s 2003 fourth fiscal quarter ended November 30, 2003:

1. Form 8-K dated September 10, 2003, Item 7.

2. Form 8-K dated September 16, 2003, Item 7.

3. Form 8-K dated September 23, 2003, Items 7 and 12.

   Exhibit 99.1 Press Release Relating to Earnings

   Exhibit 99.2 Selected Statistical Information
   (Preliminary and Unaudited)

   Exhibit 99.3 Consolidated Statement of Income
   Three Months Ended August 31, 2003
   (Preliminary and Unaudited)

   Exhibit 99.4 Consolidated Statement of Income
   Nine Months Ended August 31, 2003
   (Preliminary and Unaudited)

   Exhibit 99.5 Segment Net Revenue Information
   Three and Nine Months Ended August 31, 2003
   (Preliminary and Unaudited)

4. Form 8-K dated October 8, 2003, Item 7.

5. Form 8-K dated October 31, 2003, Item 7.

6. Form 8-K dated October 31, 2003, Items 5 and 7.

7. Form 8-K dated November 6, 2003, Item 7.

8. Form 8-K dated November 7, 2003, Item 7.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

9. Form 8-K dated November 25, 2003, Item 7.



## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

LEHMAN BROTHERS HOLDINGS INC. (REGISTRANT)

February 26, 2004

By: /s/ DAVID GOLDFARB
David Goldfarb
Chief Financial Officer and
Executive Vice President

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ RICHARD S. FULD, JR.<br>Richard S. Fuld, Jr. | Chief Executive Officer and Chairman of the Board of Directors (principal executive officer) | February 26, 2004 |
| /s/ DAVID GOLDFARB<br>David Goldfarb | Chief Financial Officer and Executive Vice President (principal financial and accounting officer) | February 26, 2004 |
| /s/ MICHAEL L. AINSLIE<br>Michael L. Ainslie | Director | February 26, 2004 |
| /s/ JOHN F. AKERS<br>John F. Akers | Director | February 26, 2004 |
| /s/ ROGER S. BERLIND<br>Roger S. Berlind | Director | February 26, 2004 |
| /s/ THOMAS H. CRUIKSHANK<br>Thomas H. Cruikshank | Director | February 26, 2004 |
| /s/ CHRISTOPHER GENT<br>Sir Christopher Gent | Director | February 26, 2004 |
| /s/ HENRY KAUFMAN<br>Henry Kaufman | Director | February 26, 2004 |
| /s/ JOHN D. MACOMBER<br>John D. Macomber | Director | February 26, 2004 |
| /s/ DINA MERRILL | Director | February 26, 2004 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Dina Merrill



**LEHMAN BROTHERS HOLDINGS INC. and SUBSIDIARIES**
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE**


| Financial Statements | Pages | |
|---|---|---|
| | Form 10-K | Annual Report |
| Report of Independent Auditors | | 66 |
| Consolidated Statement of Income for the Twelve Months Ended November 30, 2003, 2002, and 2001 | | 67 |
| Consolidated Statement of Financial Condition at November 30, 2003 and 2002 | | 68-69 |
| Consolidated Statement of Changes in Stockholders' Equity for the Twelve Months Ended November 30, 2003, 2002, and 2001 | | 70-71 |
| Consolidated Statement of Cash Flows for the Twelve Months Ended November 30, 2003, 2002 and 2001 | | 72 |
| Notes to Consolidated Financial Statements | | 73-106 |
| **Financial Statement Schedule** | | |
| Schedule I-Condensed Financial Information of Registrant | F-2 | |




**Schedule I**

**LEHMAN BROTHERS HOLDINGS INC.**
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**
**Statement of Operations**
**(Parent Company Only)**
**(In millions)**

| | Year Ended November 30, | | |
|---|---|---|---|
| | 2003 | 2002 | 2001 |
| Revenues | | | |
| Interest and dividends | $ 2,103 | $ 2,137 | $ 4,162 |
| Principal transactions and other | 80 | (34) | 404 |
| Total revenues | 2,183 | 2,103 | 4,566 |
| Interest expense | 2,662 | 2,476 | 4,364 |
| Net revenues | (479) | (373) | 202 |
| Equity in net income of subsidiaries | 2,368 | 1,229 | 1,218 |
| Non-interest expenses | 589 | 188 | 29 |
| September 11th (recoveries)/expenses, net | – | (108) | 76 |
| Other real estate reconfiguration charge | 19 | 2 | – |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | |
|---|---|---|---|
| Income before taxes | 1,281 | 774 | 1,315 |
| Provision/(benefit) for income taxes | (418) | (201) | 60 |
| Net income | $ 1,699 | $ 975 | $ 1,255 |
| Net income applicable to common stock | $ 1,649 | $ 906 | $ 1,161 |

*See notes to condensed financial information of Registrant.*



**LEHMAN BROTHERS HOLDINGS INC.**
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**

**Balance Sheet**
**(Parent Company Only)**
**(In millions, except for per share data)**

| | November 30, | |
|---|---|---|
| | 2003 | 2002 |
| **ASSETS** | | |
| Cash and cash equivalents | $ 4,892 | $ 1,980 |
| Securities and other inventory positions owned (includes $6,118 in 2003 and $4,218 in 2002 pledged as collateral) | 11,534 | 8,865 |
| Due from subsidiaries | 37,423 | 37,156 |
| Equity in net assets of subsidiaries | 12,526 | 8,029 |
| Receivables and accrued interest | 354 | 1,024 |
| Collateralized agreements | 318 | 2,735 |
| Other assets | 3,123 | 2,935 |
| Total assets | $ 70,170 | $ 62,724 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Commercial paper and short-term debt | $ 1,566 | $ 1,567 |
| Securities and other inventory positions sold but not yet purchased | 245 | 416 |
| Collateralized financing | 2,358 | 2,266 |
| Accrued liabilities and other payables | 594 | 1,324 |
| Due to subsidiaries | 19,099 | 17,525 |
| Long-term debt: | | |
| Senior notes | 31,783 | 29,952 |
| Subordinated indebtedness | 1,351 | 732 |
| Total liabilities | 56,996 | 53,782 |
| Commitments and contingencies | | |
| **STOCKHOLDERS' EQUITY** | | |
| Preferred stock | 1,045 | 700 |
| Common stock, $0.10 par value; | | |
| Shares authorized: 600,000,000 in 2003 and 2002; | | |
| Shares issued: 294,575,285 in 2003 and 258,791,416 in 2002; | | |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | 2003 | 2002 |
|---|---|---|
| Shares outstanding: 266,679,056 in 2003 and 231,131,043 in 2002 | 29 | 25 |
| Additional paid-in capital | 6,164 | 3,628 |
| Accumulated other comprehensive income (net of tax) | (16) | (13) |
| Retained earnings | 7,129 | 5,608 |
| Other stockholders' equity, net | 1,031 | 949 |
| Common stock in treasury, at cost: 27,896,229 shares in 2003 and 27,660,373 shares in 2002 | (2,208) | (1,955) |
| Total stockholders' equity | 13,174 | 8,942 |
| Total liabilities and stockholders' equity | $ 70,170 | $ 62,724 |

*See notes to condensed financial information of Registrant.*



**LEHMAN BROTHERS HOLDINGS INC.**
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**
**Statement of Cash Flows**
**(Parent Company Only)**
**(In millions)**

| | Year Ended November 30, | | |
|---|---|---|---|
| | **2003** | **2002** | **2001** |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Net income | $ 1,699 | $ 975 | $ 1,255 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in net income of subsidiaries | (2,368) | (1,229) | (1,218) |
| Depreciation and amortization | 123 | 100 | 44 |
| Tax benefit from issuance of stock-based awards | 543 | 347 | 549 |
| Deferred tax provision (benefit) | (81) | (94) | (77) |
| Amortization of deferred stock compensation | 625 | 570 | 544 |
| September 11th (recoveries)/expenses | – | (108) | 127 |
| Other real estate reconfiguration charge | 19 | 2 | – |
| Other adjustments | – | 65 | 59 |
| Net change in: | | | |
| Securities and other inventory positions owned | (1,709) | 3,473 | (2,946) |
| Securities and other inventory positions sold but not yet purchased | (171) | (568) | 740 |
| Collateralized agreements and collateralized financing, net | 2,509 | (2,366) | 675 |
| Due to/from subsidiaries, net | 1,307 | 3,573 | 2,877 |
| Other assets and liabilities, net | (588) | (934) | (847) |
| Net cash provided by operating activities | 1,908 | 3,806 | 1,782 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from issuance of long-term debt | 9,449 | 5,592 | 6,794 |
| Principal payments of long-term debt | (7,962) | (6,866) | (5,313) |
| Proceeds from issuance of preferred stock | 345 | – | – |
| Net payments for commercial paper and short-term debt | (1) | (291) | (2,310) |
| Repurchases of preferred stock | – | – | (100) |
| Repurchases of treasury stock | (1,508) | (1,510) | (1,676) |
| Issuances of treasury stock | 260 | 207 | 69 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Dividends paid | (178) | (165) | (163) |
| Issuances of common stock | 57 | 61 | 54 |
| Net cash provided by (used in) financing activities | 462 | (2,972) | (2,645) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Dividends received | 1,238 | 1,085 | 1,252 |
| Purchases of property, equipment and leasehold improvements, net | 314 | (424) | (103) |
| Business acquisitions, net of cash acquired | (657) | – | – |
| Capital contributions from / (to) subsidiaries, net | (353) | (81) | (170) |
| Net cash provided by investing activities | 542 | 580 | 979 |
| Net change in cash and cash equivalents | 2,912 | 1,414 | 116 |
| Cash and cash equivalents, beginning of period | 1,980 | 566 | 450 |
| Cash and cash equivalents, end of period | $ 4,892 | $ 1,980 | $ 566 |

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION (in millions)**

Interest paid totaled $2,692 in 2003, $2,444 in 2002 and $3,138 in 2001. Income taxes received totaled $1,059 in 2003, $233 in 2002 and $481 in 2001.

*See notes to condensed financial information of Registrant.*



**LEHMAN BROTHERS HOLDINGS INC.**
**NOTES TO CONDENSED FINANCIAL INFORMATION OF REGISTRANT**
**(Parent Company Only)**

**Note 1. Basis of Presentation**

The condensed financial statements of Lehman Brothers Holdings Inc. ("Holdings") should be read in conjunction with the consolidated financial statements of Lehman Brothers Holdings Inc. and subsidiaries (collectively, the "Company") and the notes thereto. Certain prior-period amounts reflect reclassifications to conform to the current period' s presentation. Equity in net assets of subsidiaries (investments in affiliates) is accounted for in accordance with the equity method of accounting.

**Note 2. Securities and Other Inventory Positions**

Securities and other inventory positions owned and Securities and other inventory positions sold but not yet purchased are recorded at fair value and were comprised of the following:

| **(in millions)**<br>**November 30** | **2003** | **2002** |
|---|---|---|
| Securities and other inventory positions owned: | | |
| Mortgages, mortgaged-backed and real estate inventory positions | $ 7,251 | $ 5,718 |
| Derivatives and other contractual agreements | 1,883 | 1,691 |
| Corporate debt and other | 308 | 722 |
| Corporate equities | 587 | 734 |
| Certificates of deposit and other money market instruments | 1,505 | – |
| Total | $ 11,534 | $ 8,865 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | |
|---|---|---|
| Securities and other inventory positions sold but not yet purchased: | | |
| Derivatives and other contractual agreements | $ 234 | $ 345 |
| Other | 11 | 71 |
| Total | $ 245 | $ 416 |

**Note 3. Securities Pledged as Collateral**

Holdings enters into secured borrowing and lending transactions to finance trading inventory positions, obtain securities for settlement and meet customers' needs. Holdings receives collateral in connection with resale agreements. Holdings is generally permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements or deliver to counterparties to cover short positions. Holdings carries secured financing agreements for financial reporting purposes on a net basis when permitted under the provisions of Financial Accounting Standards Board Interpretation No. 41, "*Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements*" ("FIN 41").

At November 30, 2003 and 2002, the fair value of securities received as collateral and securities owned that have not been sold, repledged or otherwise encumbered totaled approximately $4.8 billion and $4.5 billion, respectively. At November 30, 2003 and 2002, the gross fair value of securities received as collateral where Holdings was permitted to sell or repledge the securities was approximately $4.8 billion and $7.0 billion, respectively. Of this collateral, approximately $1.6 billion and $0.9 billion at November 30, 2003 and 2002, respectively, has been sold or repledged, generally as collateral under repurchase agreements or to cover Securities and other inventory positions sold but not yet purchased.

Holdings also pledges its own assets, principally to collateralize certain financing arrangements. These pledged securities, where the counterparty has the right, by contract or custom, to rehypothecate the financial instruments are classified as Securities and other inventory positions owned, pledged as collateral, in the Balance Sheet as required by Statement of Financial Accounting Standards No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*."



The carrying value of Securities and other inventory positions owned that have been pledged or otherwise encumbered to counterparties where those counterparties do not have the right to sell or repledge was approximately $2.0 billion and $2.2 billion at November 30, 2003 and 2002, respectively.

**Note 4. Business Combination**

On October 31, 2003, the Company acquired Neuberger Berman Inc. and its subsidiaries ("Neuberger") by means of a merger into a wholly-owned subsidiary of Holdings. The Company purchased Neuberger for a net purchase price of approximately $2,788 million, including cash consideration and incidental costs of $690 million, equity consideration of $2,374 million (including 32.3 million shares of common stock, 0.3 million shares of restricted common stock and 3.5 million vested stock options) and excluding net cash and short-term investments acquired of $276 million. The Company also issued approximately 0.5 million shares of restricted common stock valued at $42 million, which is subject to future service requirements and will be amortized over the applicable service periods. The value of the common shares issued that was used to record the transaction was determined based on the average closing market price of the Company' s common shares from October 27, 2003 through October 31, 2003. The vested stock options issued were valued using the Black-Scholes option-pricing model. See Notes 6 and 15 to the Company' s Consolidated Financial Statements for additional information about the business combination and employee incentive arrangements related to the acquisition.

**Note 5. Long-Term Debt**

| | U.S. Dollar | | Non-U.S. Dollar | | Total | Total |
|---|---|---|---|---|---|---|
| (in millions) | Fixed | Floating | Fixed | Floating | | |
| November 30 | Rate | Rate | Rate | Rate | 2003 | 2002 |
| Senior notes | | | | | | |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | | |
|---|---|---|---|---|---|---|
| Maturing in fiscal 2003 | $ – | $ – | $ – | $ – | $ – | $ 6,189 |
| Maturing in fiscal 2004 | 1,574 | 2,966 | 1,336 | 774 | 6,650 | 6,515 |
| Maturing in fiscal 2005 | 1,970 | 2,181 | 205 | 907 | 5,263 | 3,842 |
| Maturing in fiscal 2006 | 2,856 | 741 | 780 | 908 | 5,285 | 4,082 |
| Maturing in fiscal 2007 | 1,545 | 209 | 772 | 461 | 2,987 | 2,807 |
| Maturing in fiscal 2008 | 3,578 | 773 | 21 | 527 | 4,899 | 1,147 |
| December 1, 2008 and thereafter | 5,650 | 436 | 77 | 536 | 6,699 | 5,370 |
| Senior notes | 17,173 | 7,306 | 3,191 | 4,113 | 31,783 | 29,952 |
| Subordinated indebtedness | | | | | | |
| December 1, 2008 and thereafter | 1,351 | – | – | – | 1,351 | 732 |
| Total | $ 18,524 | $ 7,306 | $ 3,191 | $ 4,113 | $ 33,134 | $ 30,684 |

Of Holdings' long-term debt outstanding at November 30, 2003, $625 million is repayable prior to maturity at the option of the holder, at par value. These obligations are reflected in the above table at their put dates, in fiscal 2004, rather than at their contractual maturities, which range from fiscal 2004 to fiscal 2026. In addition, $4,371 million of Holdings' long-term debt is redeemable prior to maturity at the option of the Company under various terms and conditions. These obligations are reflected in the above table at their contractual maturity dates.

At November 30, 2003, Holdings' U.S. dollar and non-U.S. dollar debt portfolio included approximately $1,895 million and $998 million, respectively, of debt for which the interest rates and/or redemption values have been linked to the performance of various indices, including industry baskets of stocks, commodities or events. Generally, such notes are issued as floating rate notes or the interest rates on such index notes are effectively converted to floating rates based primarily on LIBOR through the use of interest rate, currency swaps and equity swaps.

At November 30, 2003 and 2002, Subordinated indebtedness includes $1,310 and $710 million, which has been classified as "Preferred securities subject to mandatory redemption" in the Company' s Consolidated Statement of



Financial Condition.

*End User Derivative Activities*

Holdings uses a variety of derivative products including interest rate, currency and equity swaps as an end-user to modify the interest rate characteristics of its long-term debt portfolio. Holdings uses interest rate swaps to convert a substantial portion of Holdings' fixed rate debt to floating interest rates to more closely match the terms of assets being funded and to minimize interest rate risk. In addition, Holdings uses cross-currency swaps to hedge its exposure to foreign currency risk as a result of its non-U.S. dollar debt obligations, after consideration of non-U.S. dollar assets that are funded with long-term debt obligations in the same currency. In certain instances, two or more derivative contracts may be used by Holdings to manage the interest rate nature and/or currency exposure of an individual long-term debt issuance.

At November 30, 2003 and 2002, the notional values of end-user derivatives related to long-term debt obligations were approximately $41.1 billion and $37.7 billion, respectively. In addition, end-user derivative activities resulted in the following changes to the mix of fixed and floating rate debt and effective weighted-average rates of interest:

| | Long-Term Debt | | Weighted-Average (1) | |
|---|---|---|---|---|
| (in millions)<br>November 30, 2003 | Before End User Activities | After End User Activities | Contractual Interest Rate | Effective Rate After End User Activities |
| U.S. dollar obligations | | | | |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | |
|---|---|---|---|---|
| Fixed rate | $ 18,524 | $ 1,055 | | |
| Floating rate | 7,306 | 28,871 | | |
| Total U.S. dollar | 25,830 | 29,926 | 4.95% | 1.88% |
| Non-U.S. dollar obligations | 7,304 | 3,208 | | |
| Total | $ 33,134 | $ 33,134 | 4.62% | 1.93% |

| | Long-Term Debt | | Weighted-Average (1) | |
|---|---|---|---|---|
| (in millions)<br>November 30, 2002 | Before<br>End User<br>Activities | After<br>End User<br>Activities | Contractual<br>Interest<br>Rate | Effective Rate<br>After End User<br>Activities |
| U.S. dollar obligations | | | | |
| Fixed rate | $ 17,212 | $ 1,213 | | |
| Floating rate | 6,749 | 25,732 | | |
| Total U.S. dollar | 23,961 | 26,945 | 5.41% | 2.36% |
| Non-U.S. dollar obligations | 6,723 | 3,739 | | |
| Total | $ 30,684 | $ 30,684 | 5.03% | 2.45% |

(1) Weighted-average interest rates were calculated utilizing non-U.S. dollar interest rates, where applicable.

In March 2002, Holdings issued $575 million of floating rate convertible notes. These notes bear interest at a variable rate of three-month LIBOR minus 90 basis points per annum (subject to adjustment in certain events) and mature on April 1, 2022. The notes will also bear a specified additional amount of contingent interest during any quarterly interest period following a quarterly interest period in which the average trading price of the notes is above specified levels. The notes are convertible at $96.10 per share (resulting in approximately 6 million shares), in certain circumstances, including (i) Holdings' common stock trading above $120.125 for a specified number of trading days, (ii) the trading price of the notes declining to certain levels, (iii) a significant downgrade in the ratings of the notes below a specified level, (iv) the notes being called for redemption and (v) certain other events. Holdings has the option to redeem the notes for cash on or after April 1, 2004. The holders of the notes may cause Holdings



to repurchase the notes at par on April 1, 2004, 2007, 2012 or 2017. Holdings may elect to pay the repurchase price in cash, common stock or a combination of cash and common stock. The holders of the notes may also cause Holdings to repurchase the notes for cash upon a change in control.

**Note 6. Commitments and Contingencies**

Holdings guaranteed certain senior notes and subordinated indebtedness issued by subsidiaries totaling $11,869 million and $8,352 million at November 30, 2003 and 2002, respectively. In addition, Holdings guarantees certain liquidity facilities and it guarantees certain of its subsidiaries' derivative and other obligations. Holdings also guarantees all the obligations of certain subsidiaries and selected obligations of other subsidiaries, which obligations may be included in the amounts discussed above.

**Note 7. Related Party Transactions**

In the normal course of business, Holdings engages in various securities trading and financing activities with many of its subsidiaries (the "Related Parties"). Various charges, such as compensation and benefits, occupancy, administration and computer processing are allocated between the Related Parties, based upon specific identification and other allocation methods.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In addition, Holdings and subsidiaries of Holdings raise money through short- and long-term funding in capital markets, which is used to fund the operations of certain of the Company' s wholly owned subsidiaries. Advances from Holdings to affiliates were approximately $32.6 billion and $30.2 billion at November 30, 2003 and 2002, respectively. In addition, Holdings had advances from subsidiaries aggregating $12.4 billion and $7.5 billion at November 30, 2003 and 2002, respectively.

At November 30, 2003 and 2002, Holdings has $4.2 billion and $6.6 billion, respectively, of securities purchased under agreements to resell. In addition, at November 30, 2003 and 2002, Holdings has $6.7 billion and $10.0 billion, respectively of securities sold under agreements to repurchase with Related Parties. Securities purchased under agreements to resell and securities sold under agreements to repurchase with Related Parties are included in Due from subsidiaries and Due to subsidiaries, respectively, in the Balance Sheet.

Holdings has $0.3 billion of Senior notes with a Related Party at November 30, 2003 and 2002. Holdings also has borrowings from Related Parties classified as subordinated indebtedness of approximately $1.4 billion and $0.7 billion at November 30, 2003 and 2002, respectively, with various repayment terms. Additionally, at November 30, 2003 and 2002 the Company had $1.9 billion and $1.6 billion, included within Derivatives and other contractual agreements owned, respectively, and $0.2 billion and $0.3 billion included within Derivatives and other contractual agreements sold but not yet purchased, respectively, with Related Parties.

Holdings believes amounts arising through related party transactions, including those allocated expenses referred to above, are reasonable and approximate the amounts that would have been recorded if Holdings operated as an unaffiliated entity.

Dividends declared to Holdings by its subsidiaries and affiliates were $1,238 million in 2003, $1,085 million in 2002 and $1,252 million in 2001.

Certain covenants contained in various debt agreements may restrict Holdings' ability to withdraw capital from its regulated subsidiaries, which in turn could limit its ability to pay dividends to shareholders. At November 30, 2003, approximately $5.8 billion of net assets of subsidiaries were restricted as to the payment of dividends to Holdings.



---

**Note 8. September 11 and Real Estate Reconfiguration Charges**

As a result of the September 11, 2001 terrorist attack, Holdings' leased facilities in the World Trade Center ("WTC") were destroyed and its leased and owned facilities in the World Financial Center ("WFC") complex (including the 3 World Financial Center building owned jointly with American Express) were significantly damaged. All employees and operations in the downtown New York area were displaced. Key business activities and necessary support functions were quickly relocated to back-up facilities in New Jersey and to various other temporary sites.

Holdings had insurance in place to cover the losses resulting from the terrorist attack, including a policy covering damage to the core and shell of the 3 WFC building and a separate policy covering the property damage at the WTC and WFC facilities, losses resulting from business interruption and extra expenses associated with the Company' s relocation to, and occupancy of, the temporary facilities.

During 2001, Holdings' recognized a pre-tax charge of $76 million ($42 million after-tax) associated with the net losses stemming from the events of September 11, 2001. The losses and costs include the write-off of property damaged, destroyed or abandoned at the Company' s downtown facilities (approximately $127 million), compensation paid to employees in lieu of utilizing external consultants for business recovery efforts and to employees for the time they were idled (approximately $39 million), and other costs associated with redeployment of the Company' s workforce to the temporary facilities (approximately $30 million). The losses and costs were offset by estimated insurance recoveries of $120 million in 2001. The insurance recovery recorded through November 30, 2001 was limited to the net historical book value of assets believed damaged, destroyed or abandoned and the out-of-pocket costs for certain extra expenses incurred during the period.

During the fourth quarter of 2001, Holdings purchased a new building in midtown Manhattan located at 745 7th Avenue and entered into long-term leases in Jersey City, New Jersey and midtown Manhattan, as uncertainties continued to persist associated with the Company' s ability to

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

utilize its previous downtown headquarters at 3 World Financial Center. During the fourth quarter of 2002, after further consideration of maintaining real estate in both downtown and midtown New York City locations, Holdings decided to completely exit its downtown area facilities and dispose of certain other excess New York City area space acquired as a result of the events of September 11$^{th}$, resulting in a charge of approximately $37 million.

During the fourth quarter of 2002, Holdings settled its insurance claim for $700 million, the policy limit, with its insurance carriers. This resulted in the recording of a net pre-tax recovery of $108 million ($60 million after-tax) in the fourth quarter of 2002. The net gain of $108 million in fiscal 2002 included insurance recoveries of approximately $166 million, costs associated with exiting certain of Holdings' New York area facilities of $37 million, and $21 million of other costs resulting from the events of September 11$^{th}$ (primarily technology restoration and other costs associated with unusable facilities). Insurance recoveries recorded in 2002 represent Holdings' settlement of $700 million offset by Holdings' insurance recoveries previously recognized during 2001 ($120 million), and insurance recoveries allocated to affiliates of Holdings of approximately $240 million during 2001 and $174 million during 2002.

During the second quarter of 2003, the Company recorded a $19 million pre-tax real estate charge ($11 million after tax). This charge represented an adjustment of the real estate charges recognized in 2002 and reflected a continued softening in the New York metropolitan area sublease markets since the fourth quarter of 2002.



The Company expects substantially all of such facilities will be subleased by the end of 2004. During the years ended November 30, 2003, 2002, and 2001 changes in the liability, which is included in Accrued liabilities and other payables in the Balance Sheet, related to these charges were as follows:

| (in millions) | Beginning Balance | September 11$^{th}$ Charge Before Insurance Recoveries** | Real-Estate Reconfiguration | Utilized* | Ending Balance |
|---|---|---|---|---|---|
| Year ended November 30, 2001 | $ − | $ 196 | $ − | $ (155) | $ 41 |
| Year ended November 30, 2002 | 41 | 58 | 2 | (11) | 90 |
| Year ended November 30, 2003 | 90 | − | 19 | (32) | 77 |

* Net of accretions of $7 million in 2003.

** The Company recognized insurance recoveries of $120 million and $166 million in 2001 and 2002, respectively.

**Note 9. Condensed Consolidating Financial Statement Schedules**

LBI, a wholly-owned subsidiary of Holdings, had approximately $1.7 billion of debt securities outstanding at November 30, 2003 that were issued in registered public offerings and were therefore subject to the reporting requirements of Sections 13(a) and 15(d) of the Securities Exchange Act of 1934. Holdings has fully and unconditionally guaranteed these outstanding debt securities of LBI (and any debt securities of LBI that may be issued in the future under these registration statements), which, together with the information presented in this Note 9, allows LBI to avail itself of an exemption provided by SEC rules from the requirement to file separate LBI reports under the Exchange Act. See Note 17 to the Company' s Consolidated Financial Statements for a discussion of restrictions on the ability of Holdings to obtain funds from its subsidiaries by dividend or loan.

The following schedules set forth the Company' s condensed consolidating statement of income for the years ended November 30, 2003, 2002 and 2001, the Company' s condensed consolidating balance sheet as of November 30, 2003 and 2002, and the Company' s condensed consolidating statement of cash flows for the years ended November 30, 2003, 2002 and 2001. In the following schedules, "Holdings" refers to the unconsolidated balances of Holdings, "LBI" refers to the unconsolidated balances of Lehman Brothers Inc. and "Other Subsidiaries"

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

refers to the combined balances of all other subsidiaries of Holdings. "Eliminations" represents the adjustments necessary to (a) eliminate intercompany transactions and (b) eliminate the Company' s investments in subsidiaries.



Condensed Consolidating Statement of Income for the Year Ended November 30, 2003

| (in millions) | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Net revenues | $ (479) | $ 4,901 | $ 4,225 | $ – | $ 8,647 |
| Equity in net income of subsidiaries | 2,368 | 205 | – | (2,573) | – |
| Total non-interest expenses | 608 | 3,306 | 2,197 | – | 6,111 |
| Income before taxes and dividends on preferred securities subject to mandatory redemption | 1,281 | 1,800 | 2,028 | (2,573) | 2,536 |
| Provision (benefit) for income taxes | (418) | 617 | 566 | – | 765 |
| Dividends on preferred securities subject to mandatory redemption | – | – | 72 | – | 72 |
| Net income | $ 1,699 | $ 1,183 | $ 1,390 | $ (2,573) | $ 1,699 |

Condensed Consolidating Statement of Income for the Year Ended November 30, 2002

| (in millions) | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Net revenues | $ (373) | $ 3,174 | $ 3,354 | $ – | $ 6,155 |
| Equity in net income of subsidiaries | 1,229 | 261 | – | (1,490) | – |
| Total non-interest expenses | 82 | 2,515 | 2,159 | – | 4,756 |
| Income before taxes and dividends on preferred securities subject to mandatory redemption | 774 | 920 | 1,195 | (1,490) | 1,399 |
| Provision (benefit) for income taxes | (201) | 180 | 389 | – | 368 |
| Dividends on preferred securities subject to mandatory redemption | – | – | 56 | – | 56 |
| Net income | $ 975 | $ 740 | $ 750 | $ (1,490) | $ 975 |

Condensed Consolidating Statement of Income for the Year Ended November 30, 2001

| (in millions) | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Net revenues | $ 202 | $ 3,728 | $ 2,806 | $ – | $ 6,736 |
| Equity in net income of subsidiaries | 1,218 | 199 | – | (1,417) | – |
| Total non-interest expenses | 105 | 2,752 | 2,131 | – | 4,988 |
| Income before taxes and dividends on preferred securities subject to mandatory redemption | 1,315 | 1,175 | 675 | (1,417) | 1,748 |
| Provision (benefit) for income taxes | 60 | 320 | 57 | – | 437 |
| Dividends on preferred securities subject to mandatory redemption | – | – | 56 | – | 56 |
| Net income | $ 1,255 | $ 855 | $ 562 | $ (1,417) | $ 1,255 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Condensed Consolidating Balance Sheet At November 30, 2003

| (in millions) | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | $ 4,892 | $ 159 | $ 2,871 | $ – | $ 7,922 |
| Cash and securities segregated and on deposit for regulatory and other purposes | – | 1,920 | 1,180 | – | 3,100 |
| Securities and other inventory positions owned | 11,534 | 47,674 | 126,954 | (49,122) | 137,040 |
| Collateralized agreements | 318 | 97,166 | 41,328 | – | 138,812 |
| Equity in net assets of subsidiaries | 12,526 | 1,355 | 28,694 | (42,575) | – |
| Receivables and other assets | 3,477 | 12,183 | 20,675 | (11,148) | 25,187 |
| Due from subsidiaries | 37,423 | 36,065 | 191,398 | (264,886) | – |
| Total assets | $ 70,170 | $ 196,522 | $ 413,100 | $ (367,731) | $ 312,061 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | | | |
| Commercial paper and short-term debt | $ 1,566 | $ 96 | $ 669 | $ – | $ 2,331 |
| Securities and other inventory positions sold but not yet purchased | 245 | 35,657 | 88,860 | (48,880) | 75,882 |
| Collateralized financing | 2,358 | 83,823 | 49,655 | – | 135,836 |
| Accrued liabilities and other payables | 594 | 15,860 | 34,912 | (11,367) | 39,999 |
| Due to subsidiaries | 19,099 | 52,454 | 184,378 | (255,931) | – |
| Long-term debt | 33,134 | 5,326 | 14,047 | (8,978) | 43,529 |
| Total liabilities | 56,996 | 193,216 | 372,521 | (325,156) | 297,577 |
| Commitments and contingencies | – | – | – | – | |
| Preferred securities subject to mandatory redemption | – | – | 1,310 | – | 1,310 |
| Total stockholders' equity | 13,174 | 3,306 | 39,269 | (42,575) | 13,174 |
| Total liabilities and stockholders' equity | $ 70,170 | $ 196,522 | $ 413,100 | $ (367,731) | $ 312,061 |



Condensed Consolidating Balance Sheet At November 30, 2002

| (in millions) | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and cash equivalents | $ 1,980 | $ 82 | $ 1,637 | $ – | $ 3,699 |
| Cash and securities segregated and on deposit for regulatory and other purposes | – | 1,894 | 949 | (40) | 2,803 |
| Securities and other inventory positions owned | 8,865 | 44,461 | 96,324 | (30,372) | 119,278 |
| Collateralized agreements | 2,735 | 83,998 | 28,105 | – | 114,838 |
| Equity in net assets of subsidiaries | 8,029 | 1,160 | 18,505 | (27,694) | – |
| Receivables and other assets | 3,959 | 10,279 | 15,442 | (9,962) | 19,718 |
| Due from subsidiaries | 37,156 | 14,732 | 157,215 | (209,103) | – |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| Total assets | $ 62,724 | $ 156,606 | $ 318,177 | $ (277,171) | $ 260,336 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | | | |
| Commercial paper and short-term debt | $ 1,567 | $ 112 | $ 690 | $ – | $ 2,369 |
| Securities and other inventory positions sold but not yet purchased | 416 | 38,276 | 60,698 | (30,356) | 69,034 |
| Collateralized financing | 2,266 | 82,439 | 30,001 | – | 114,706 |
| Accrued liabilities and other payables | 1,324 | 12,034 | 22,673 | (10,134) | 25,897 |
| Due to subsidiaries | 17,525 | 16,015 | 163,442 | (196,982) | – |
| Long-term debt | 30,684 | 4,578 | 15,421 | (12,005) | 38,678 |
| Total liabilities | 53,782 | 153,454 | 292,925 | (249,477) | 250,684 |
| | | | | | |
| Commitments and contingencies | – | – | – | – | – |
| Preferred securities subject to mandatory redemption | – | – | 710 | – | 710 |
| Total stockholders' equity | 8,942 | 3,152 | 24,542 | (27,694) | 8,942 |
| Total liabilities and stockholders' equity | $ 62,724 | $ 156,606 | $ 318,177 | $ (277,171) | $ 260,336 |



Condensed Consolidating Statement of Cash Flows for the Year Ended November 30, 2003

| (in millions) | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | |
| Net income | $ 1,699 | $ 1,183 | $ 1,390 | $ (2,573) | $ 1,699 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | | |
| Equity in net income of subsidiaries | (2,368) | (205) | – | 2,573 | – |
| Depreciation and amortization | 123 | 36 | 156 | – | 315 |
| Tax benefit from issuance of stock-based awards | 543 | – | – | – | 543 |
| Deferred tax provision (benefit) | (81) | (149) | 64 | – | (166) |
| Amortization of deferred stock compensation | 625 | – | – | – | 625 |
| Other real estate reconfiguration charge | 19 | 31 | 27 | – | 77 |
| Other adjustments | – | 36 | (62) | – | (26) |
| Net change in: | | | | | |
| Cash and securities segregated and on deposit | – | (26) | (231) | (40) | (297) |
| Securities and other inventory positions owned | (1,709) | (3,249) | (34,848) | 23,658 | (16,148) |
| Securities and other inventory positions sold but not yet purchased | (171) | (2,619) | 28,162 | (18,524) | 6,848 |
| Collateralized agreements and collateralized financing, net | 2,509 | (11,785) | 6,432 | – | (2,844) |
| Due to/from affiliates, net | 1,307 | 15,105 | (10,230) | (6,182) | – |
| Other assets and liabilities, net | (588) | 1,976 | 7,574 | 2,959 | 11,921 |
| Net cash provided by (used in) operating activities | 1,908 | 334 | (1,566) | 1,871 | 2,547 |
| | | | | | |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | | |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | |
|---|---|---|---|---|---|
| Proceeds from issuance of long-term debt | 9,449 | 1,300 | 4,744 | (2,110) | 13,383 |
| Principal payments of long-term debt | (7,962) | (514) | (1,900) | 239 | (10,137) |
| Proceeds from issuance of trust issued securities | – | – | 600 | – | 600 |
| Proceeds from issuance of preferred stock | 345 | – | – | – | 345 |
| Net payments for commercial paper and short-term debt | (1) | (16) | (21) | – | (38) |
| Payments for treasury stock purchases | (1,508) | – | – | – | (1,508) |
| Issuance of treasury stock | 260 | – | – | – | 260 |
| Dividends paid | (178) | (1,080) | (238) | 1,318 | (178) |
| Issuances of common stock | 57 | – | – | – | 57 |
| Net cash provided by (used in) financing activities | 462 | (310) | 3,185 | (553) | 2,784 |
| | | | | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | |
| Dividends received | 1,238 | 80 | – | (1,318) | – |
| Purchases of property, equipment and leasehold improvements, net | 314 | (12) | (753) | – | (451) |
| Business acquisitions, net of cash acquired | (657) | – | – | – | (657) |
| Capital contributions from / (to) subsidiaries, net | (353) | (15) | 368 | – | – |
| Net cash used in investing activities | 542 | 53 | (385) | (1,318) | (1,108) |
| Net change in cash and cash equivalents | 2,912 | 77 | 1,234 | – | 4,223 |
| Cash and cash equivalents, beginning of period | 1,980 | 82 | 1,637 | – | 3,699 |
| Cash and cash equivalents, end of period | $ 4,892 | $ 159 | $ 2,871 | $ – | $ 7,922 |



Condensed Consolidating Statement of Cash Flows for the Year Ended November 30, 2002

| **(in millions)** | **Holdings** | **LBI** | **Other Subsidiaries** | **Eliminations** | **Total** |
|---|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | |
| Net income | $ 975 | $ 740 | $ 750 | $ (1,490) | $ 975 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | | |
| Equity in net income of subsidiaries | (1,229) | (261) | – | 1,490 | – |
| Depreciation and amortization | 100 | 32 | 126 | – | 258 |
| Tax benefit from issuance of stock-based awards | 347 | – | – | – | 347 |
| Deferred tax provision (benefit) | (94) | (139) | (437) | – | (670) |
| Amortization of deferred stock compensation | 570 | – | – | – | 570 |
| September 11$^{th}$ (recoveries)/expenses | (108) | – | – | – | (108) |
| Other real estate reconfiguration charge | 2 | 8 | 118 | – | 128 |
| Regulatory settlement | – | 80 | – | – | 80 |
| Other adjustments | 65 | 21 | 6 | – | 92 |
| Net change in: | | | | | |
| Cash and securities segregated and on deposit | – | 878 | (392) | – | 486 |
| Securities and other inventory positions owned | 3,473 | (395) | 8,719 | (10,089) | 1,708 |
| Securities and other inventory positions sold but not yet purchased | (568) | 3,715 | 9,280 | 5,277 | 17,704 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | |
|---|---|---|---|---|---|
| Collateralized agreements and collateralized financing, net | (2,366) | (8,804) | (10,119) | – | (21,289) |
| Due to/from affiliates, net | 3,573 | 6,386 | (15,023) | 5,064 | – |
| Other assets liabilities, net | (934) | (859) | 7,241 | 288 | 5,736 |
| Net cash provided by (used in) operating activities | 3,806 | 1,402 | 269 | 540 | 6,017 |
| | | | | | |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | | |
| Proceeds from issuance of long-term debt | 5,592 | 800 | 2,831 | (808) | 8,415 |
| Principal payments of long-term debt | (6,866) | (705) | (2,426) | 268 | (9,729) |
| Net payments for commercial paper and short-term debt | (291) | (889) | (443) | – | (1,623) |
| Payments for treasury stock purchases | (1,510) | – | – | – | (1,510) |
| Issuances of treasury stock | 207 | – | – | – | 207 |
| Dividends paid | (165) | (1,085) | (80) | 1,165 | (165) |
| Issuance of common stock | 61 | – | – | – | 61 |
| Net cash provided by (used in) financing activities | (2,972) | (1,879) | (118) | 625 | (4,344) |
| | | | | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | |
| Dividends received | 1,085 | 80 | – | (1,165) | – |
| Purchases of property, equipment and leasehold improvements, net | (424) | (8) | (224) | – | (656) |
| Business acquisitions, net of cash acquired | – | – | (31) | – | (31) |
| Proceeds from the sale of 3 WFC | – | 152 | – | – | 152 |
| Capital contributions from / (to) subsidiaries | (81) | 46 | 35 | – | – |
| Net cash used in investing activities | 580 | 270 | (220) | (1,165) | (535) |
| Net change in cash and cash equivalents | 1,414 | (207) | (69) | – | 1,138 |
| Cash and cash equivalents, beginning of period | 566 | 289 | 1,706 | – | 2,561 |
| Cash and cash equivalents, end of period | $ 1,980 | $ 82 | $ 1,637 | $ – | $ 3,699 |



Condensed Consolidating Statement of Cash Flows for the Year Ended November 30, 2001

| (in millions) | Holdings | LBI | Other Subsidiaries | Eliminations | Total |
|---|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | |
| Net income | $ 1,255 | $ 855 | $ 562 | $ (1,417) | $ 1,255 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | | |
| Equity in net income of subsidiaries | (1,218) | (199) | – | 1,417 | – |
| Depreciation and amortization | 44 | 61 | 69 | – | 174 |
| Tax benefit from issuance of stock-based awards | 549 | – | – | – | 549 |
| Deferred tax provision (benefit) | (77) | (139) | (427) | – | (643) |
| Amortization of deferred stock compensation | 544 | – | – | – | 544 |
| September 11th (recoveries)/expenses | 127 | 229 | – | – | 356 |
| Other adjustments | 59 | (2) | (58) | – | (1) |
| Net change in: | | | | | |
| Cash and securities segregated and on deposit | – | (798) | (57) | – | (855) |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | |
|---|---|---|---|---|---|
| Securities and other inventory positions owned | (2,946) | (1,257) | (13,857) | 4,841 | (13,219) |
| Securities and other inventory positions sold but not yet purchased | 740 | 14,487 | 9,517 | (8,699) | 16,045 |
| Collateralized agreements and collateralized financing, net | 675 | (381) | (523) | – | (229) |
| Due to/from affiliates, net | 2,877 | (13,523) | 6,564 | 4,082 | – |
| Other assets and liabilities, net | (847) | (1,208) | (1,246) | (374) | (3,675) |
| Net cash provided by (used in) operating activities | 1,782 | (1,875) | 544 | (150) | 301 |
| | | | | | |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | | |
| Proceeds from issuance of long-term debt | 6,794 | 800 | 2,321 | – | 9,915 |
| Principal payments of long-term debt | (5,313) | (400) | (2,287) | 150 | (7,850) |
| Proceeds from issuance of preferred stock | – | – | – | – | – |
| Net payments for commercial paper and short-term debt | (2,310) | 351 | 151 | – | (1,808) |
| Repurchases of preferred stock | (100) | – | – | – | (100) |
| Payments for treasury stock purchases | (1,676) | – | – | – | (1,676) |
| Issuances of treasury stock | 69 | – | – | – | 69 |
| Dividends paid | (163) | (1,052) | (200) | 1,252 | (163) |
| Issuances of common stock | 54 | – | – | – | 54 |
| Net cash provided by (used in) financing activities | (2,645) | (301) | (15) | 1,402 | (1,559) |
| | | | | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | |
| Dividends received | 1,252 | – | – | (1,252) | – |
| Purchases of property, equipment and leasehold improvements, net | (103) | 303 | (1,541) | – | (1,341) |
| Capital contributions from / (to) subsidiaries, net | (170) | – | 170 | – | – |
| Net cash used in investing activities | 979 | 303 | (1,371) | (1,252) | (1,341) |
| Net change in cash and cash equivalents | 116 | (1,873) | (842) | – | (2,599) |
| Cash and cash equivalents, beginning of period | 450 | 2,162 | 2,548 | – | 5,160 |
| Cash and cash equivalents, end of period | $ 566 | $ 289 | $ 1,706 | $ – | $ 2,561 |



## EXHIBIT INDEX

| Exhibit No. | Exhibit |
|---|---|
| 10.12 | Lehman Brothers Supplemental Retirement Plan, as amended through December 10, 2003 |
| 12.01 | Computations in support of ratio of earnings to fixed charges and ratio of earnings to combined fixed charges and preferred stock dividends |
| 13.01 | The following portions of the Company' s 2003 Annual Report to Stockholders, which are incorporated by reference herein: "Management' s Discussion and Analysis," "Report of Independent Auditors," "Consolidated Financial Statements," "Notes to Consolidated Financial Statements," "Selected Financial Data" and "Other Stockholder Information" on pages 32 - 108. |
| 21.01 | List of the Registrant' s Subsidiaries |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| 23.01 | Consent of Ernst & Young LLP |
| 24.01 | Powers of Attorney |
| 31.01 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and 15d-14(a) |
| 31.02 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and 15d-14(a) |
| 32.01 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Enacted by Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.02 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Enacted by Section 906 of the Sarbanes-Oxley Act of 2002 |

---

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 10.12**

**Lehman Brothers Holdings Inc.**
**SUPPLEMENTAL RETIREMENT PLAN**

(Effective as of October 19, 1998, amended and restated effective December 10, 2003)

PREAMBLE

The Lehman Brothers Holdings Inc. Supplemental Retirement Plan (as amended and restated effective December 10, 2003) (the "Plan") is established by Lehman Brothers Holdings Inc. (the "Company") for the sole purpose of providing the Chairman and employees of the Company or its subsidiaries who are the Members of the Company' s non-Board Executive Committee (the "Executive Committee") and other key employees of the Company as determined in the sole discretion of the Committee (as defined below) with supplemental retirement payments. The Plan was originally effective as of October 19, 1998, and was amended and restated effective December 10, 2003. This document describes the benefits provided under the Plan. The Plan reads as follows:

ARTICLE 1

DEFINITIONS

1.1 Benefit Commencement Date: The date on which payment of Full or Prorata Benefits shall begin, as described under Section 4.3.1 of the Plan.

1.2 Board: The Board of Directors of the Company.

1.3 Cause: A material breach by a Participant of an employment contract or other agreement, if any, between the Participant and the Company and any of its subsidiaries, failure by a Participant to devote substantially all business time exclusively to the performance of his duties for the Company or its subsidiaries, willful misconduct, dishonesty related to the business and affairs of the Company or any subsidiary, conviction of, or a plea of nolo contendere to, a felony or of a misdemeanor constituting a statutory disqualification under U.S. securities laws (or failure to contest prosecution for such a felony or such a misdemeanor), habitual or gross negligence in the performance of a Participant' s duties, the violation of policies and practices adopted by the Company or any subsidiary including, but not limited to the Code of Conduct, engaging in Competitive Activity or Detrimental Activity, or such other circumstances as may be determined by the Committee in its sole discretion. Following the occurrence of a Change in Control, "Cause" shall mean (i) the substantial and continuing failure by a Participant to perform the Participant' s duties for the Company (other than any such failure resulting from incapacity due to physical or mental illness), at least thirty (30) days after a written demand for performance is delivered to the Participant by the Board which specifically identifies the manner in which the Board believes that the Participant

has not performed the Participant' s duties, (ii) conviction of, or plea of guilty or nolo contendere to, a felony or of or to a misdemeanor constituting a statutory disqualification under U.S. securities laws or (iii) engaging in willful misconduct which is demonstrably injurious to the Company.

Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or upon the instructions of the Chairman or based upon the advice of counsel for the Company shall be conclusively presumed not to constitute either willful misconduct or Detrimental Activity. Following the occurrence of a Change in Control, the cessation of employment of the Participant

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

shall not be deemed to be for Cause unless and until there shall have been duly adopted by the affirmative vote of not less than three-quarters (3/4) of the entire membership of the Board (excluding the Participant if the Participant is a member of the Board) at a meeting of the Board called and held for such purpose (after reasonable notice is provided to the Participant and the Participant is given an opportunity, together with counsel, to be heard before the Board) a resolution finding that, in the good faith opinion of the Board, the Participant has committed the conduct described in (i) or (ii) above, and specifying the particulars thereof in detail.

1.4 Chairman: Chairman of the Executive Committee as of October 19, 1998.

1.5 Change in Control: The occurrence during the term of the Plan of:

(a) The commencement (within the meaning of Rule 14d-2 under the Securities Exchange Act of 1934 (the "Exchange Act")) of a tender offer for more than 20% of the Company' s outstanding shares of capital stock having ordinary voting power in the election of directors (the "Voting Securities");

(b) An acquisition (other than directly from the Company) of any voting securities of the Company by any "Person" (as the term person is used for purposes of Section 13(d) or 14(d) of the Exchange Act) immediately after which such Person has "Beneficial Ownership" (within, the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of the combined voting power of the Company' s then outstanding Voting Securities; provided, however, in determining whether a Change in Control has occurred, Voting Securities which are acquired in a "Non-Control Acquisition" (as hereinafter defined) shall not constitute an acquisition which would cause a Change in Control. A "Non-Control Acquisition" shall mean an acquisition by (i) an employee benefit plan (or a trust forming a part thereof or a trustee thereof acting solely in its capacity as trustee) maintained by (A) the Company or (B) any corporation or other Person of which a majority of its voting power or its voting equity securities or equity interest is owned, directly or indirectly, by the Company (for purposes of this definition, a "Subsidiary"), (ii) the Company or its Subsidiaries, or (iii) any



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Person who files in connection with such acquisition a Schedule 13D which expressly disclaims any intention to seek control of the Company and does not expressly reserve the right to seek such control; provided, however, that any amendment to such statement of intent which either indicates an intention or reserves the right to seek control shall be deemed an "acquisition" of the securities of the Company reported in such filing as beneficially owned by such Person for purposes of this paragraph (b);

(c) The individuals who, as of the effective date of the 1994 initial public trading in Company shares, are members of the Board (the "Incumbent Board"), ceasing for any reason to constitute at least a majority of the members of the Board; provided, however, that if the election, or nomination for election by the Company' s common stockholders, of any new director was approved by a vote of at least two-thirds of the Incumbent Board, such new director shall, for purposes of this Plan, be considered as a member of the Incumbent Board; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the Exchange Act or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board (a "Proxy Contest") including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest; or

(d) Approval by stockholders of the Company of:

(i) A merger, consolidation or reorganization involving the Company, unless such merger, consolidation or reorganization is a "Non-Control Transaction"; i.e., meets each of the requirements described in (A), (B), and (C) below:

(A) the stockholders of the Company, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, at least fifty percent (50%) of the combined voting power of the outstanding voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Corporation") in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute at least a majority of the members of the board of directors of the Surviving



Corporation immediately following the consummation of such merger, consolidation or reorganization; and

(C) no Person other than the Company, any Subsidiary, any employee benefit plan (or any trust forming a part thereof or a trustee thereof acting solely in its capacity as trustee) maintained by the Company, the Surviving Corporation, or any Subsidiary, or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Corporation' s then outstanding voting securities immediately following the consummation of such merger, consolidation or reorganization.

(ii) A complete liquidation or dissolution of the Company; or

(iii) An agreement for the sale or other disposition of all or substantially all of the assets of the Company to any Person (other than a transfer to a Subsidiary).

Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by the Company which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Persons, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by the Company and thereafter such Beneficial Owner acquires any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

1.6 Committee: The Compensation and Benefits Committee of the Board.

1.7 Company: Lehman Brothers Holdings Inc. and except as otherwise specified in this Plan in a particular context, any successor thereto, whether by merger, consolidation or acquisition of substantially all of its assets.

1.8 Competitive Activity: Involvement (whether as an employee, proprietor, consultant or otherwise) with any person or entity (including any company and its affiliates) engaged in any business activity which is materially competitive with any business carried on by the Company or any of its subsidiaries on the date of termination of a Participant' s employment with the Company and any of its subsidiaries, as determined in the sole discretion of the Committee. Following the occurrence of a Change in Control, the determination of whether a Participant has engaged in



"Competitive Activity" shall be made by a resolution duly adopted by the affirmative vote of three-quarters (3/4) of the entire membership of the Board (excluding the Participant if the Participant is a member of the Board) at a meeting of the Board called and held for such purpose (after reasonable notice is provided to the Participant and the Participant is given an opportunity, together with counsel, to be heard before the Board) finding that, in the good faith opinion of the Board, the Participant has committed the conduct described in the preceding sentence and that such conduct is demonstrably injurious to the Company.

1.9 Detrimental Activity: means at any time (i) using information received during a person' s employment with the Company or any subsidiary , their affiliates or clients, in breach of such person' s undertakings to keep such information confidential; (ii) directly or indirectly persuading or attempting to persuade, by any means, any employee of the Company or any subsidiary to terminate his or her employment with the foregoing or to breach any of the terms of his or her employment with the foregoing; (iii) directly or indirectly making any statement that is, or could be, disparaging of the Company, its subsidiaries or affiliates, or any of their employees (except as necessary to respond truthfully to any inquiry from applicable regulatory authorities or to provide information pursuant to legal process); or (iv) directly or indirectly engaging in any activity (other than Competitive Activity) that is substantially injurious to the financial condition, reputation, or goodwill of the Company or its subsidiaries or affiliates, in each case as determined in the sole discretion of the Committee. Following the occurrence of a Change in Control, the determination of whether a Participant has engaged in "Detrimental Activity" shall be made by a resolution duly adopted by the affirmative vote of three-quarters (3/4) of the entire membership of the Board (excluding the Participant if the Participant is a member of the Board) at a meeting of the Board called and held for such purpose (after reasonable notice is provided to the Participant and the Participant is given an opportunity, together with counsel, to be heard before the Board) finding that, in the good faith opinion of the Board, the Participant has committed the conduct described in (i), (ii), (iii), or (iv) above and that such conduct is demonstrably injurious to the Company.

1.10 Disability: A disability under the Company' s Long-Term Disability Plan or any other condition, which in the sole discretion of the Committee constitutes a disability for purposes of this Plan.

1.11 Domestic Partner: An individual is a "Domestic Partner" with respect to a Participant for purposes of this Plan if such individual and the Participant have a currently registered domestic partnership with a governmental body pursuant to state or local law authorizing such registration. In the absence of a formal registration, a Participant can register his or her domestic partnership with another individual by filing an affidavit with the Lehman Brothers Benefits Service Center, and such individual shall qualify as a Domestic Partner of such Participant for purposes of this Plan for so long as such domestic partnership shall remain in effect.



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

1.12 Full Benefits: Benefits under the Plan as described under Section 4.1 and payable pursuant to Section 4.3.

1.13 Good Reason: The occurrence following a Change in Control of any of the following without either Cause or a Participant' s express written consent:

(a) a material adverse change in a Participant' s title, position, authority or key responsibilities as compared to the Participant' s title, position, authority or key responsibilities immediately prior to the Change in Control, excluding for this purpose an action not taken in bad faith and which is remedied by the Company promptly after receipt of notice thereof given by the Participant;

(b) a material reduction in a Participant' s annual base salary or incentive compensation opportunities as compared to the Participant' s annual base salary and incentive compensation opportunities as in effect immediately prior to the Change in Control; or

(c) any requirement that the Executive (A) be based anywhere more than fifty (50) miles from the office where the Executive was located immediately prior to the Change in Control or (B) travel on Company business to an extent substantially greater than the Executive' s travel obligations immediately prior to the Change in Control.

1.14 Member: Any person who is serving on the Executive Committee as of October 19, 1998, but who is not the Chairman.

1.15 Participant: Each Member and the Chairman and any other person who is subsequently designated as a participant in the Plan pursuant to Section 3.1.

1.16 Present Value: The discounted present value of a payment or stream of payments to be made at a future date, as determined by the actuary of the Qualified Plan using the interest rate applicable under the Qualified Plan to determine lump sum payments made at such time.

1.17 Prorata Benefits: Benefits under the Plan as described under Section 4.2 and payable pursuant to Section 4.3.

1.18 Qualified Plan: The Lehman Brothers Holdings Inc. Retirement Plan as from time to time in effect.

1.19 Spouse: The individual to whom a Participant is legally married on the date of his death. An individual shall be treated as the Spouse of a Participant and as legally married to such Participant for such period as such individual shall qualify as the Domestic Partner of such Participant.

1.20 Trust: The trust or trusts described in Section 2.3.



---

1.21 Trustee: The trustee of the Trust.

1.22 Years of Service: A Participant' s "years of vesting service" as determined under the Qualified Plan.

Usage. Whenever applicable, the masculine gender, when used in the Plan, will include the feminine gender, and the singular will include the plural.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

ARTICLE 2

COMPANY FUNDING OBLIGATIONS

2.1 In General. The Company shall have no obligation under the Plan to make any payments or cause any payments to be made except as explicitly provided under this Plan.

2.2 Unfunded Plan. The Plan is intended to constitute an unfunded plan for a select group of management or highly compensated employees as defined in sections 201(2), 301(a)(3) and 401(a)(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). All amounts payable under the Plan shall be paid out of the general assets of the Company, and any individuals entitled to have payments made on their behalf under the Plan shall have no rights to payment greater than the rights of general unsecured creditors of the Company.

2.3 Rabbi Trust. The Company shall establish promptly a revocable trust to hold assets, subject to the claims of the Company' s creditors in the event of the Company' s insolvency, for the purpose of the payment of the benefits hereunder, which shall become irrevocable upon the first to occur of any of the events described in Section 1.5(a), (b) or (c), or upon the consummation of a merger, consolidation, reorganization, complete liquidation or dissolution, or agreement for sale or other disposition of all or substantially all of the assets of the Company as described in Section 1.5(d). The Company shall contribute to the Trust cash in such amounts and at such times as are specified in this Plan and in the Trust. Amounts paid to Participants from the Trust shall discharge the obligations of the Company hereunder to the Participants to the extent of the payments so made.

ARTICLE 3

PARTICIPATION AND ELIGIBILITY

3.1 Participation. Participation in the Plan is limited initially to the Chairman and the Members. The Committee, in its sole discretion, may extend the benefits of this Plan to other key employees of the Company.

3.2 Eligibility for Full Benefits. A Participant is eligible to receive Full Benefits as described in Section 4.1 under the Plan if:



(a) (i) he retires on or after he attains age sixty (60) or the combination of his age and number of Years of Service exceeds eighty-five (85), and (ii) he has not otherwise forfeited his benefits under Section 4.5 of this Plan;

(b) (i) he is a Participant other than a Member or the Chairman and retires after fulfilling any combination of eligibility criteria other than as specified in paragraph 3.2(a), if any, that has been communicated to such Participant in writing by the Committee in connection with such Participant' s initial participation in the Plan, and (ii) he has not otherwise forfeited his benefits under Section 4.5 of this Plan; or

(c) (i) within three (3) years following the occurrence of a Change in Control, his employment is terminated by the Company without Cause or the Participant terminates his employment with Good Reason, and (ii) he has not otherwise forfeited his benefits under Section 4.5 of this Plan.

(1) Notwithstanding the foregoing, if all or any portion of the above payouts, either alone or together with other payments and benefits a Participant receives or is then entitled to receive from the Company

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

and its subsidiaries, would constitute a payment described in Section 280G(b)(2) (or its successors) of the Internal Revenue Code of 1986, as amended (the "Code"), such payments and benefits provided to the Participant shall be reduced to the extent necessary so that no portion thereof shall be subject to the excise tax imposed by Section 4999 of the Code; but only if, by reason of such reduction, the net after tax benefit to the Participant shall exceed the net after tax benefit if such reduction were not made. For this purpose, the determination as to whether such payments and benefits constitute a payment described in Code Section 280G(b)(2) and as to the amount of such reduction, if any, necessary to avoid the excise tax shall be based upon the agreement of the Company and the Participant, or in the absence of such agreement, a determination by the accounting firm as described in (2) below. In the event of a determination that such reduction is to take place, the Participant shall be entitled to designate which payments and benefits shall be reduced, but in the event the Participant fails to make such designation within 15 days following notification of such determination, the Company shall allocate the reduction among such payments and benefits in its sole discretion; provided, however, that the payments provided pursuant to the Plan shall be the last payments to be reduced.

(2) "Net after tax benefit" shall mean the sum of (A) the total payments payable to the Participant hereunder, plus (B) all other payments and benefits which the Participant receives



or is then entitled to receive from the Company and its subsidiaries that would constitute a payment described in Section 280G(b)(2) of the Code, less (C) the amount of federal, state and local income taxes payable with respect to the foregoing calculated at the maximum marginal income tax rate for each year in which the foregoing shall be paid to the Participant (based upon the rate in effect for such year as set forth in the Code at the time of termination of the Participant' s employment), less (D) the amount of excise taxes imposed with respect to the payments and benefits described in (A) and (B) above by Section 4999 of the Code. The foregoing calculations shall be made, at the Company' s expense, by the Company and the Participant. If no agreement on the calculations is reached, the Participant and the Company shall agree to the selection of an accounting firm to make the calculations. If no agreement can be reached regarding the selection of an accounting firm, the Company shall select a nationally recognized accounting firm other than the Company' s independent auditors. The determination of any such firm selected shall be conclusive and binding on all parties.

(3) In the event a determination is made as described in (1) and (2) above that any such payouts are to be reduced and if such determination occurs after the Participant has received accelerated awards as described above without such reduction having been made, the amount by which such payment is to be reduced as provided above shall be deemed to be a loan from the Company to the Participant and shall be due and payable by the Participant to the Company three days following notification by the Company to the Participant of such determination and the amount owing. No interest shall be due on such amount and the Company shall hold the Participant harmless, on an after-tax basis, from any excise tax or income tax (including interest or penalties with respect thereto) imposed with respect to such amount or with respect to any imputed income with respect to such advance.

3.3 Eligibility for Prorata Benefits. A Participant is eligible to receive Prorata Benefits as described in Section 4.2 under the Plan if:

(a) he terminates his employment (i) after attaining age forty-five (45) or having completed five (5) Years of Service (but before he attains age sixty (60) or the combination of his age and number of Years of Service exceed eighty-five (85)) or (ii) if he is a Participant other than a Member or the Chairman, after fulfilling any combination of eligibility criteria other than as specified in clause (i) of this paragraph, if any, that has been communicated to



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

such Participant in writing by the Committee in connection with such Participant' s initial participation in the Plan, and

(b) he has not otherwise forfeited his benefits under Section 4.5 of this Plan.

ARTICLE 4

BENEFITS

4.1 Amount of Full Benefit. In accordance with the payment provisions of Section 4.3, a Participant who meets the eligibility requirements under Section 3.2 shall be eligible to receive Full Benefits under the Plan. Full Benefits shall be equal to (a) twenty-five (25) annual payments of $700,000 for Participants other than the Chairman and (b) twenty-five (25) annual payments of $1,250,000 for the Chairman.

4.2 Amount of Prorata Benefit. In accordance with the payment provisions of Section 4.3, a Participant who meets the eligibility requirements under Section 3.3 shall be eligible to receive Prorata Benefits under the Plan. Prorata Benefits shall be equal to (a) twenty-five (25) annual payments of $700,000 for Participants other than the Chairman and (b) twenty-five (25) annual payments of $1,250,000 for the Chairman, multiplied by the ratio of (A) the Participant' s Years of Service at termination or retirement to (B) the projected Years of Service the Participant would have had at age sixty (60) (or, if the Participant is other than a Member or the Chairman, at such other age for eligibility for Full Benefits that is communicated to such Participant in writing by the Committee at the time of such Participant' s initial participation in the Plan) had his employment not terminated.

4.3 Payment of Benefits.

4.3.1 Except as provided in Section 4.4, Full and Prorata Benefits under the Plan shall commence the first day of the first month coincident with or next following the later of (a) the month that a Participant attains age sixty (60), or (b) the month a Participant retires or terminates employment with the Company (the "Benefit Commencement Date").

4.3.2 Prior to the occurrence of a Change in Control, each Participant shall be entitled to make an election pursuant to which, in the event such Participant' s employment is terminated within three (3) years following a Change in Control either by the Company without Cause or by the Participant for Good Reason, he shall be entitled to receive in one lump sum payment the Present Value of his Full or Prorata Benefits, as applicable, as soon as practicable after such termination of employment.



---

4.4 Benefits on Death or Disability.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

4.4.1 In the event of the death of the Participant after the Benefit Commencement Date, his Spouse, if any, shall receive annually the remainder of the Participant' s annual payments under the Plan. If the Spouse shall die before all annual payments have been paid (or if the Participant has no Spouse on the date of his death), the Present Value of the remaining payments shall be paid in one lump sum to such Spouse' s estate (or the Participant' s estate, as the case may be) as soon as practicable following the date of death of such Spouse (or of the Participant, as the case may be).

4.4.2 In the event of the death of a Participant prior to the Benefit Commencement Date, payments of any Full Benefits (if the Participant had then satisfied the requirements of Section 3.2) or Prorata Benefits (if the Participant had then satisfied the requirements of Section 3.3) shall be paid annually to the Participant' s Spouse commencing on the later of (i) the first day of the month immediately following the Participant' s death or (ii) the first day of the month coincident with or next following the month during which the Participant would have attained age sixty (60). If the Spouse shall die before all annual payments have been paid or before benefit payment commences (or if the Participant has no Spouse on the date of his death), the Present Value of the remaining payments shall be paid in one lump sum to such Spouse' s estate (or the Participant' s estate, as the case may be) as soon as practicable following the date of death of such Spouse (or of the Participant, as the case may be).

4.4.3 In the event of the death or Disability of a Participant, the Committee may, in its sole discretion, (i) increase the Participant' s Prorata Benefit up to a maximum of the Full Benefit, (ii) accelerate the date on which payment of Full or Prorata Benefits commences to any date prior to the otherwise applicable Benefit Commencement Date, and (iii) provide that the Present Value of the Participant' s Prorata or Full Benefit (or the Present Value of the remaining payments, as applicable) shall be paid immediately in one lump sum.

4.5 Forfeiture and Cessation of Payments. A Participant shall forfeit all rights to Full or Prorata Benefits (including the right to any such benefits after the Benefit Commencement Date) if (i) he engages in Competitive Activity at any time other than following termination of his employment (A) by the Company without Cause within three (3) years following a Change in Control or (B) by the Participant with Good Reason within three (3) years following a Change in Control, (ii) he engages in Detrimental Activity at any time, (iii) his employment is terminated with Cause, (iv) he is a Member or the Chairman and his employment terminates on or before July 1, 2001, or (v) he is a Participant other than a Member or the Chairman and his employment terminates for a reason other than death or Disability before the earlier of (x) the date determined by the Committee in connection with such Participant' s initial participation in the Plan and (y) a Change in Control.

4.6 Withholding. All payments and benefits under the Plan shall be subject to any applicable withholding requirements imposed by any tax or other law. The



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Company shall have the right to satisfy any withholding obligation against any other payments, including regular wages, due the Participant.

ARTICLE 5

AMENDMENT AND TERMINATION

5.1 Amendment and Termination. Subject to Section 5.2, the Company, by action of the Committee, may at any time amend the Plan, retroactively or otherwise, in any respect or terminate the Plan; provided, however, that no such amendment or termination shall reduce the amount of Full or Prorata Benefit for which a Participant was eligible under the Plan in effect immediately prior to the date of such amendment or termination (determined as though the Participant' s employment with the Company had then terminated but without regard to the requirement of Section 4.5 relating to employment on July 1, 2001, or such later date, as specified by the Committee with respect to a Participant who is neither a Member nor the Chairman); and further provided that no amendment made within six (6) months before a Change in Control or at any time after a Change in Control that reduces or otherwise adversely affects a Participant' s rights with respect to Full or Prorata Benefits shall be given effect.

5.2 Restrictions on Company' s Action. Without the express written consent of the Participant, no action taken by the Company shall adversely affect a Participant' s (or his Spouse' s) right to receive a Full or Prorata Benefit upon satisfaction by the Participant of the conditions precedent to entitlement to such a benefit as they exist under the terms of the Plan in effect immediately prior to such action, and at the time and on the terms then in effect. Notwithstanding the foregoing, the Company reserves the right to pay in one lump sum the Present Value of any Full or Prorata Benefit upon termination of the Plan.

5.3 Notwithstanding anything herein to the contrary, the provisions of this Article 5 may not be amended without the express written consent of each Participant.

ARTICLE 6

ADMINISTRATION; FUNDING OF TRUST

6.1 Committee. The Plan shall be administered by the Committee. Without limiting the generality of the foregoing, the Committee shall have the power and discretion:

(a) to make and enforce rules and regulations and to prescribe the use of forms necessary or advisable for efficient administration of the Plan;

(b) to interpret the Plan, to resolve ambiguities, inconsistencies and omissions and to decide questions concerning the eligibility of any person to



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

receive benefits under the Plan, such interpretations, resolutions and decisions to be final and conclusive on all persons;

(c) to direct payment of amounts due with respect to each Participant under the Plan;

(d) to delegate authority to agents and other persons to act on its or his behalf in carrying out the provisions and administration of the Plan and to take or direct any action required or advisable with respect to the administration of the Plan and Trust; and

(e) to perform any other acts as the Committee deems necessary or appropriate for the proper administration of this Plan.

6.2 Claims Procedure. If any claim for benefits under the Plan is denied, the Committee shall follow procedures similar to those then in effect under the Qualified Plan for notifying the applicant of such denial and for affording the applicant an opportunity to appeal such denial.

6.3 Service of Process. The Company or such other person as may from time to time be designated by the Committee shall be the agent for service of process under the Plan.

6.4 No Bond Required. No bond or other security shall be required of any individual or the Committee except as may be required by law.

6.5 Limitation of Liability; Indemnity. Except to the extent otherwise provided by law, if any duty or responsibility of the Committee has been allocated or delegated to any other person in accordance with any provision of the Plan, then the Committee shall not be liable for any act or omission of such person in carrying out such duty or responsibility. The Company shall indemnify and save each person who is a member of the Committee and each employee or director of the Company harmless against any and all loss, liability, claim, damage, cost and expense which may arise by reason of, or be based upon, any matter connected with or related to the Plan or the administration of the Plan (including, but not limited to, any and all expenses whatsoever reasonably incurred in investigating, preparing or defending against any litigation, commenced or threatened, or in settlement of any such claim whatsoever) to the fullest extent permitted under applicable law.

6.6 Powers of the Committee. Notwithstanding any other provisions of this Plan or the Trust to the contrary, the Committee may:

(a) accelerate a Participant' s eligibility for Prorata or Full Benefits under the Plan;



(b) pay the Present Value of any Full or Prorata Benefit in one lump sum cash payment;

(c) establish eligibility criteria for any Participant other than a Member or the Chairman to receive Full and Prorata Benefits, provided such criteria are communicated to each such Participant in writing by the Committee at the time of such Participant' s initial participation in the Plan; and

(d) cause the Company to fund the Trust at any time by determining each Participant' s Full or Prorata Benefit and causing the Company to contribute to a separate account maintained for each Participant under the Trust, in cash, an amount equal to the Present Value of such Participant' s Full or Prorata Benefit (or, if annual payments have already commenced, the Present Value of the remaining benefit) less any amount credited to such Participant' s account under the Trust as of the date of the contribution.

Notwithstanding the provisions of paragraph (d), the Committee shall upon the occurrence of a Change in Control determine each Participant' s Full or Prorata Benefit as of the end of such Participant' s latest completed month of service. Within five (5) days following such a Change in Control (or, if later, on the date when every Participant' s Full or Prorata Benefit has been determined), the Company shall contribute to a separate account maintained for each Participant under the Trust, in cash, an amount equal to 110% of the

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Present Value of each such Participant' s Full or Prorata Benefit (or, if annual payments have already been made, the Present Value of the remaining payments) less any amount credited to such Participant' s account under the Trust as of the date of the contribution. Within five (5) days of each anniversary of the Change in Control (or, if later, on the date when each Participant' s benefit that has accrued as of the date of such anniversary has been determined), the Company shall make an additional contribution to the Trust, in cash, such that the amount maintained in each Participant' s account shall equal at least 110% of the then Present Value of each such Participant' s Full or Prorata Benefit (or, if annual payments have already been made, the Present Value of the remaining payments) less any amount credited to such Participant' s account under the Trust as of the date of such additional contribution. Notwithstanding anything in this Plan to the contrary, as of each anniversary of the Change in Control, the Company shall be entitled to receive, if it so elects, a payment from the Trust such that after such payment, the assets credited to each Participant' s account equal at least 120% of the then Present Value of the Participant' s Full or Prorata Benefit (or, if annual payments have already been made, the Present Value of the remaining payments). For purposes of determining the Present Value of amounts described in this paragraph for Participants who have not commenced receiving benefits under the Plan, the Company shall assume that each Participant' s Benefit Commencement Date will occur at age sixty (60), or if a Participant has already attained age sixty (60), will occur immediately.

6.7 Legal Fees and Interest. If after the occurrence of a Change in Control, (i) a dispute arises with respect to the enforcement of a Participant' s rights under



this Plan, or (ii) any legal or arbitration proceeding shall be brought to enforce or interpret any provision contained herein or to recover damages for breach hereof and the Participant prevails in whole or in part, in either case so long as the Participant is not acting in bad faith, the Participant shall recover from the Company any reasonable attorneys' fees and necessary costs and disbursements incurred as a result of such dispute, legal or arbitration proceeding ("Expenses"), and prejudgment interest on any money judgment or arbitration award obtained by the Participant calculated at the prime rate of interest as reported by *The Wall Street Journal* from the date that payments to the Participant should have been made under this Plan. Within ten (10) days after the Participant' s written request therefor, the Company shall pay to such Participant, or such other person or entity as such Participant may designate in writing to the Company, the Participant' s Expenses.

## ARTICLE 7

## MISCELLANEOUS

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

7.1 Payment to Incompetent. If any person entitled to benefits under this Plan shall be a minor or shall be either physically or mentally incompetent in the judgment of the Committee, such benefits may be paid pursuant to the same procedures as specified from time to time under the Qualified Plan. In the event of such payment the Company and the Trust shall be discharged from all further liability for such payment.

7.2 Doubt as to Right to Payment. If any doubt exists as to the right of any person to any benefits under this Plan or the amount of time of payment of such benefits (including, without limitation, any case of doubt as to identity, or any case in which any notice has been received from any other person claiming any interest in amounts payable hereunder, or any case in which a claim from other persons may exist by reason of community property or similar laws), the Committee will be entitled, in its discretion, to direct that payment of such benefits be deferred until such right or amount or time is determined or until order of a court of competent jurisdiction, or to pay such sum into court in accordance with appropriate rules of law in such case then provided, or to make payment only upon receipt of a bond or similar indemnification (in such amount and in such form as is satisfactory to the Committee).

7.3 Spendthrift Clause. To the maximum extent permitted by law, (a) no benefit, distribution or payment under the Plan may be anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution or other legal or equitable process, whether pursuant to a "qualified domestic relations order", as defined in section 414(p) of the Code, or otherwise; and (b) the Plan shall in no manner be liable for or subject to the debts or liabilities of any Participant.

7.4 Data. Any Participant or Spouse entitled to benefits under the Plan must furnish to the Committee such documents, evidence or information as the Committee considers necessary or desirable for the purpose of administering the Plan, or



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

to protect the Committee; and it is a condition of the Plan that each such Participant or Spouse must furnish promptly true and complete data, evidence or information and sign such documents as the Committee may require before any benefits become payable under the Plan.

7.5 Separability. If any provision of the Plan is held invalid or unenforceable, its invalidity or unenforceability will not affect any other provisions of the Plan, and the Plan will be construed and enforced as if such provision had not been included therein.

7.6 Captions. The captions contained herein are inserted only as a matter of convenience and for reference and in no way define, limit, enlarge or describe the scope or intent of the Plan nor shall, in any way, affect the Plan or the construction of any provision thereof.

7.7 Right of Discharge Reserved. The establishment of the Plan shall not be construed to confer upon any Participant any legal right to be retained in the employ of the Company or give any Participant or any other person any right to benefits, except to the extent expressly provided for hereunder. All Participants will remain subject to discharge to the same extent as if the Plan had never been adopted, and may be treated without regard to the effect such treatment might have upon them under the Plan.

7.8 Not Compensation for Other Plans. No compensation payable as a consequence of participation in the Plan shall be considered in calculating or determining benefits, coverage or contributions under any other employee benefit plan or program, unless otherwise explicitly provided under such plan or program or as otherwise required by applicable law.

7.9 Arbitration. Prior to a Change in Control, any dispute, controversy or claim between a Participant and the Company arising out of or relating to or concerning the provisions of the Plan shall be finally settled by arbitration in the City of New York before, and in accordance with, the commercial arbitration rules of the American Arbitration Association ("AAA"). If, after the occurrence of a Change in Control, any dispute, controversy or claim arises between a Participant and the Company out of or relating to or concerning the provisions of the Plan, such dispute, controversy or claim shall be finally settled by a court of competent jurisdiction in the City of New York which, notwithstanding the provisions of Article 6 or any other provision of the Plan, shall apply a de novo standard of review to any determination made by the Company, the Board or the Committee.

7.10 Governing Law and Limitations on Actions. The Plan is intended to constitute an arrangement that is unfunded and maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees, all within the meaning of ERISA, as amended. To that extent, rights under this Plan shall be governed by and construed in accordance with rules of Federal law applicable to such plans. To the extent that such rules of Federal law are not



applicable, the Plan shall be construed, and all provisions hereof shall be enforced and administered, according to the laws of the State of New York without regard to principles of choice of law; provided, however, that any determination of whether a Change in Control has occurred for purposes of this Plan shall be determined in accordance with the laws of the State of Delaware without regard to principles of choice of law. No action (whether at law, in equity or otherwise) or arbitration claim shall be brought by or on behalf of any Participant or Spouse for or with respect to benefits due under this Plan unless the person bringing such action has timely exhausted the Plan' s claim review procedure. Any action (whether at law, in equity or otherwise) or arbitration claim must be commenced within three years. This three year period shall be computed from the earlier of (a) the date a final determination denying such benefit, in whole or in part, is issued under the Plan' s claim review procedure and (b) the date such individual' s cause of action first accrued (as determined under the laws of the State of New York or the State of Delaware, as applicable, without regard to principles of choice of laws).



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

IN WITNESS WHEREOF, LEHMAN BROTHERS HOLDINGS INC. has caused this instrument to be executed by its duly authorized officers, and its corporate seal to be hereunto affixed, this 10th day of December, 2003.

LEHMAN BROTHERS HOLDINGS INC.

By: /s/ Tracy Binkley

Title: Vice President and
Director of Global Human Resources

ATTEST:
/s/ Madeline L. Shapiro
Assistant Secretary



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 12.01**

**LEHMAN BROTHERS HOLDINGS INC. and SUBSIDIARIES**
**COMPUTATION of RATIOS of EARNINGS to FIXED CHARGES and**
**to COMBINED FIXED CHARGES and PREFERRED STOCK DIVIDENDS**
**(Dollars in millions)**
**(Unaudited)**

| | For the Twelve Months Ended November 30 | | | | |
|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| Pre-tax earnings from continuing operations | $ 1,631 | $ 2,579 | $ 1,748 | $ 1,399 | $ 2,536 |
| Add: Fixed charges (excluding capitalized interest) | 13,681 | 18,778 | 15,724 | 10,709 | 8,724 |
| Pre-tax earnings before fixed charges | 15,312 | 21,357 | 17,472 | 12,108 | 11,260 |
| Fixed charges: | | | | | |
| Interest | 13,649 | 18,740 | 15,656 | 10,626 | 8,640 |
| Other(a) | 71 | 57 | 78 | 103 | 119 |
| Total fixed charges | 13,720 | 18,797 | 15,734 | 10,729 | 8,759 |
| Preferred stock and trust preferred dividend requirements | 174 | 195 | 192 | 155 | 143 |
| Total combined fixed charges and preferred stock dividends | $ 13,894 | $ 18,992 | $ 15,926 | $ 10,884 | $ 8,902 |
| RATIO OF EARNINGS TO FIXED CHARGES | 1.12 | 1.14 | 1.11 | 1.13 | 1.29 |
| RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED STOCK DIVIDENDS | 1.10 | 1.12 | 1.10 | 1.11 | 1.26 |

(a) Other fixed charges consist of the interest factor in rentals and capitalized interest.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**Exhibit 13.01**

**2003**

FINANCIAL REPORT


**33** **Management' s Discussion and Analysis of Financial Condition and Results of Operations**

*33* *Certain Factors Affecting Results of Operations*

*34* *Executive Overview*

*36* *Results of Operations*

*40* *Segments*

*46* *Geographic Diversification*

*47* *Liquidity, Funding and Capital Resources*

*53* *Summary of Contractual Obligations and Commitments*

*56* *Off-Balance Sheet Arrangements*

*58* *Risk Management*

*61* *Critical Accounting Policies and Estimates*

*65* *New Accounting Developments*

65 *Effects of Inflation*

**66** **Report of Independent Auditors**

**67** **Consolidated Financial Statements**

**73** **Notes to Consolidated Financial Statements**

**107** **Selected Financial Data**

**108** **Other Stockholder Information**




**MANAGEMENT' S DISCUSSION AND ANALYSIS**

**OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Lehman Brothers Holdings Inc. (“Holdings”) and subsidiaries (collectively, the “Company” or “Lehman Brothers”) is a leading financial services firm that provides investment banking and capital markets facilitation to a global client base. The Company’ s business activities are divided into three segments: Investment Banking, Capital Markets and Client Services. The investment banking industry is significantly influenced by worldwide economic conditions as well as other factors inherent in the global financial markets. As a result, revenues and earnings may vary from quarter to quarter and from year to year.

**Forward-Looking Statements**

Some of the statements contained in this Management’ s Discussion and Analysis of Financial Condition and Results of Operations, including those relating to the Company’ s strategy and other statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “estimates” and similar expressions, are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These statements are not historical facts but instead represent only the Company’ s expectations, estimates and projections regarding future events. These statements are not guarantees of future performance and involve uncertainties that are difficult to predict, which may include, but are not limited to, the factors listed below. As a global investment bank, the Company’ s results of operations have varied significantly in response to global economic and market trends and geopolitical events. The nature of the Company’ s business makes predicting the future trends of revenues difficult. Caution should be used when extrapolating historical results to future periods.

The Company’ s actual results and financial condition may differ, perhaps materially, from the anticipated results and financial condition in any such forward-looking statements and, accordingly, readers are cautioned not to place undue reliance on such statements. The Company undertakes no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

## CERTAIN FACTORS AFFECTING RESULTS OF OPERATIONS

The Company’ s results of operations may be affected by uncertain or unfavorable economic, market, legal and other conditions. These conditions include but are not limited to:

**Market Fluctuations and Volatility**

Changes in interest and foreign exchange rates, securities, commodities and real estate valuations and increases in volatility can increase credit and market risks and may also impact customer-flow-related revenues and proprietary trading revenues as well as impact the volume of debt and equity underwritings and merger and acquisition transactions. The Company uses derivatives and other financial contracts to hedge many of these market risks.

**Industry Competition and Changes in Competitive Environment**

Increased competition from banking institutions, asset managers and non-traditional financial services providers and industry consolidation could impact fees earned from the Company’ s Investment Banking, Client Services and Capital Markets businesses.

**Investor Sentiment**

Recent accounting and corporate governance scandals have had a significant impact on investor confidence. In addition, geopolitical concerns about terrorist activities can affect the global financial markets.

**Liquidity**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Liquidity and liquidity management are of critical importance to the Company. Liquidity could be impacted by the inability to access the long-term or short-term debt markets or the repurchase and securities-lending markets. However, the Company' s liquidity and funding policies have been designed with the goal of providing sufficient



liquidity resources to continually fund its balance sheet and to meet its obligations in all market environments.

**Credit Ratings**

The Company' s access to the unsecured funding markets is dependent upon the Company' s credit ratings. A reduction in the Company' s credit ratings could adversely affect the Company' s access to liquidity alternatives and its competitive position, and could increase the cost of funding or trigger additional collateral requirements.

**Credit Exposure**

Credit risk represents the possibility that a counterparty will be unable to honor its contractual obligations to the Company. Although the Company actively manages credit risk exposure daily as part of its risk management framework, counterparty default risk may arise from unforeseen events or circumstances.

**Legal/Regulatory**

Legal and regulatory changes in the U.S. and other jurisdictions could have unfavorable effects on the Company' s businesses and results of operations. In particular, there have been a number of legislative, legal and regulatory developments related to research analyst conflicts of interest and mutual fund trading issues in the financial services industry that may affect future results of operations. In 2002, the U.S. Congress enacted the Sarbanes-Oxley Act, which significantly affected corporate governance and securities laws. In addition, various Federal and state securities regulators, self-regulatory organizations (including the New York Stock Exchange) and industry participants reviewed and, in many cases, adopted significant changes to their established rules including rules in the areas of corporate governance, potential research analyst conflicts of interest and auditor independence.

**Neuberger Berman Integration**

The Company acquired Neuberger Berman Inc. and its subsidiaries ("Neuberger"), an asset management company, in October 2003. The Company' s ability to achieve the anticipated benefits of the merger, including revenue and cost synergies, is dependent upon a number of factors, certain of which may be beyond the Company' s control. These synergies may not be realized in the anticipated amounts or time frame. For additional information about this acquisition see the Client Services business segment discussion on page 45 and Note 6 to the Consolidated Financial Statements.

## EXECUTIVE OVERVIEW

**Business Environment**

The principal business activities of the Company are investment banking, capital markets facilitation and asset management, which by their nature are subject to volatility, primarily due to changes in interest and foreign exchange rates, security and real estate valuations, global economic and political trends and industry competition. Through the Company' s investment banking, trading, research, structuring and distribution capabilities in equity and fixed income products, the Company continues to build on its client/customer business model. This model focuses on customer flow activities. The customer flow model is based on the Company' s principal focus of facilitating customer

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

transactions in all major global capital markets products and services. The Company generates customer flow revenues from institutional and high-net-worth clients/customers by (i) advising on and structuring transactions specifically suited to meet client needs; (ii) serving as a market-maker and/or intermediary in the global marketplace, including having securities and other financial instrument products available to allow clients to rebalance their portfolios and diversify risks across different market cycles; (iii) providing asset management services; and (iv) acting as an underwriter to clients. In addition to its customer flow activities, the Company also takes proprietary positions.

During 2003, the global market environment began to emerge from a prolonged slump. Gross domestic product ("GDP") growth rates began to improve, worldwide capacity indicated core inflation would remain low, labor markets began showing signs of stabilization, and corporate governance issues and geopolitical concerns eased their grip on investor sentiment−all serving to increase the sense of stability. While expectations improved as 2003 progressed, a global economic recovery was not yet fully in evidence.

The fixed income markets performed extremely well in 2003, benefiting from a historically low interest rate environment, improved investor confidence as economic indicators became increasingly positive, and significantly lower levels of corporate downgrades and defaults. During 2003, the U.S. Treasury rate reached a 45-year low, and credit spreads tightened significantly. During the second half of 2003, the fixed income markets saw significant steepening of treasury curves in the U.S. and Japan on the prospects of stronger economic growth. Bond market volatility soared during the second half of 2003, resulting in record fixed income related volumes as customers reallocated investment portfolios and engaged in more dynamic hedging.

The U.S. equity markets reached an 18-month high late in the year, as GDP growth, corporate profitability, manufacturing indices and capital spending all improved. The S&P 500 and NASDAQ indices rose 13% and 33%, respectively, in the year ended November 30, 2003. Monetary and fiscal policy provided an additional stimulus in the form



of a 25 basis-point rate cut by the Federal Reserve in June and tax policy changes enacted earlier in the year, both of which had the objective of encouraging more rapid growth.

Global fixed income origination volumes reached a record high in 2003. Investment grade spreads tightened compared with 2002 and, together with low absolute interest rates, led to a favorable environment for new issues, which increased 25% from 2002. The high yield market also benefited as low rates and significantly tighter credit spreads resulted in more than a doubling of the 2002 volume levels. Throughout 2003, issuers took advantage of interest rates that remained low even though rates began an upward climb in the second half of 2003 from the historical lows reached earlier in the year. Equity origination market volume in 2003 declined 2% from the already depressed levels of 2002; however origination activity improved in the second half of 2003, as economic indicators showed more consistent signs of recovery. Equity issuance was concentrated in secondaries, follow-ons and convertibles, while IPO volume declined a further 42% compared with already depressed 2002 levels.

Europe followed the U.S. lead in terms of monetary policy as both the European Central Bank and the Bank of England reduced interest rates. Even with such stimulus, European economic growth continued to trail U.S. levels with three of Europe' s major economies−Germany, Italy and the Netherlands−all in recession. However, anticipation of stronger U.S. growth prompted the major European equity indices to rally on the prospect of an export driven recovery. The FTSE 100 and DAX composite rose 4% and 13%, respectively, during 2003. Asian equity markets also exhibited gains during the year, with the Hang Seng index rising 22% during 2003. In Japan, stronger GDP growth, increased corporate profitability, central bank focus on deflation, and progress in bank reform caused the Nikkei to rise 10% in 2003.

Mergers and acquisitions ("M&A") completions in fiscal 2003 were the lowest in over five years, with corporate executives awaiting definitive signs of an economic and market recovery before initiating transactions. Volumes were down 17% from fiscal 2002. However, M&A activity showed some signs of improving in late 2003, and the dollar value of overall announced M&A transactions rose 8% in 2003 from 2002.

**Economic Outlook**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The financial services industry remains highly linked to global economic growth both in banking and capital markets. The Company expects U.S. GDP to increase by 4.4% in 2004 as the recovery solidifies. The Company anticipates more moderate growth rates of 1.5% in Europe and 2.3% in Japan, with robust growth of 6.8% in Asia excluding Japan. The Company expects fiscal and monetary policy to remain supportive during 2004 and expects that the low interest rate environment will continue to persist for some time.

The Company anticipates that the equities markets will continue strengthening, supported by expansive monetary policy, equity valuations that are attractive relative to bonds, increasing corporate cash flows, and growing investor confidence. The corporate profit recovery has been a key element supporting a stronger equity market. With market appreciation and diminished volatility, the equity origination markets have become more active, and equity origination volume in the last half of 2003 represented the most active issuance period since 2000. Given these economic factors, the Company expects equity origination to continue to improve throughout 2004.

While the Company does not expect fixed income origination levels to reach the record volume of $9.6 trillion issued in 2003, the outlook for fixed income origination is still quite positive. The Company expects a drop in 2004 originations by approximately 15%−still representing the second highest level of annual fixed income origination volume. Weaker mortgage and high grade issuance in 2004 are expected to be partly offset by stronger levels of public finance, sovereign, high yield, emerging market and asset-backed offerings.

The Company believes the favorable economic fundamentals that existed in 2003 will remain in place throughout 2004, resulting in continued strength in fixed income customer flow-related activity. Globally, the fixed income market has grown over 50% since 1999 to a market size of over $19 trillion in par value of securities outstanding, the market is significantly more diverse. Given the sheer size and diversity of this market and the natural flow of principal and coupon inherent to these securities, the Company believes the baseline level of fixed income flow and activity has increased well beyond that experienced in the past. As the market has become far more global, the Company anticipates continued growth of securitization products in both Europe and Asia.

The outlook for Client Services is also positive, given favorable demographics and the trends toward pension reform, higher savings rates globally, and intergenerational wealth transfer. The high-net-worth client increasingly seeks multiple providers and greater asset diversification along with a high service component. The Company believes the significant expansion of its asset management business, including the October 2003 Neuberger acquisition, was well-timed, and integration is progressing well.

With the Company' s diversified business model, the scale of the Company' s businesses, the increased market share the Company now enjoys, the productivity of the Company' s people, the prudent manner in which the Company' s businesses are managed day to day, and management' s outlook for the global economy and for the Company' s individual businesses, the Company believes it is well-positioned to continue to perform at the upper end of its peer group throughout the various stages of the business and economic cycle.



**RESULTS OF OPERATIONS (1)**

The Company provides a full array of capital markets products, investment banking services and investment management and advisory services worldwide. Through the Company' s banking, trading, research, structuring and distribution capabilities in equity and fixed income products, the Company continues to effectively build its client/customer business model. This model focuses on customer flow activities, which represent a preponderance of the Company' s revenues. In addition to its customer flow activities, the Company also takes proprietary positions, the success of which is dependent upon its ability to anticipate economic and market trends. The Company believes its customer flow orientation helps to mitigate its overall revenue volatility.

The Company, through its subsidiaries, is a market maker in all major equity and fixed income products in both the U.S. and international markets. To facilitate its market-making activities, the Company is a member of all principal securities and commodities exchanges in the U.S. and holds memberships or associate memberships on several principal international securities and commodities

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

exchanges including the London, Tokyo, Hong Kong, Frankfurt, Milan and Paris stock exchanges. As part of its customer flow activities, the Company maintains inventory positions of varying amounts across a broad range of financial instruments that are marked-to-market daily and, along with proprietary trading positions, give rise to Principal transactions and net interest revenue.

Net income totaled $1,699 million or $6.35 per diluted share in 2003, up 74% and 83%, respectively, from net income of $975 million and diluted earnings per share of $3.47 in 2002. Net revenues rose 40% to $8,647 million in 2003 from $6,155 million in 2002. The improvements reflect strong performance in Capital Markets, complemented by modest improvements in debt underwriting and Client Services activities. Equity underwriting and M&A advisory declined moderately compared with already depressed 2002 levels, as global market volumes declined further. The effect of the global equity underwriting volume decline was somewhat offset by the Company' s improved market share. Overall revenue growth is primarily attributable to a more favorable economic climate in 2003, and the continued growth in the depth and breadth of the Capital Markets customer franchise. Net income and diluted earnings per share in 2002 declined 22% and 21%, respectively, from $1,255 million and $4.38 in 2001. Net revenues in 2002 declined $581 million or 9% from $6,736 in 2001.

The Company continues to maintain a strict discipline in its core competencies around managing expenses, risk and capital. Compensation and benefits expense as a percentage of net revenues was 49.9% in 2003 and 51.0% in both 2002 and 2001. Non-personnel expenses in 2003, 2002 and 2001 include a number of special items described on page 38 (the "Special Items").

Non-personnel expenses rose 11% (13% excluding the Special Items) in 2003 compared with 2002 and rose 4% (7% excluding the Special Items) in 2002 compared with 2001. Non-personnel expenses as a percentage of net revenue were 21%, 26% and 23%, respectively, in 2003, 2002 and 2001 (20%, 25% and 21% in 2003, 2002 and 2001, respectively, excluding the Special Items).

Return on average common stockholders' equity was 18.2%, 11.2% and 15.9% in 2003, 2002 and 2001, respectively (18.7%, 12.2% and 16.9%, respectively, excluding the Special Items). The Special Items reduced diluted earnings per share by $0.17, $0.30 and $0.26 in 2003, 2002 and 2001, respectively. Average common stockholders' equity was appropriately weighted for the effect of the equity issued in connection with the Neuberger acquisition on October 31, 2003.

(1) Market share, volume and ranking statistics in this Management' s Discussion and Analysis were obtained from Thomson Financial.

**NET REVENUES**

| **IN MILLIONS** | | | | **Percent Change** | |
|---|---|---|---|---|---|
| **YEAR ENDED NOVEMBER 30** | **2003** | **2002** | **2001** | **2003/2002** | **2002/2001** |
| Principal transactions | **$ 4,280** | $ 1,951 | $ 2,779 | 119% | (30)% |
| Investment banking | **1,747** | 1,771 | 2,000 | (1) | (11) |
| Commissions | **1,210** | 1,286 | 1,091 | (6) | 18 |
| Interest and dividends | **9,942** | 11,728 | 16,470 | (15) | (29) |
| Other | **108** | 45 | 52 | 140 | (13) |
| Total revenues | **17,287** | 16,781 | 22,392 | 3 | (25) |
| Interest expense | **8,640** | 10,626 | 15,656 | (19) | (32) |
| Net revenues | **$ 8,647** | $ 6,155 | $ 6,736 | 40% | (9)% |



Net revenues totaled $8,647 million, $6,155 million and $6,736 million in 2003, 2002 and 2001, respectively. Net revenues in 2003 were a record for the Company, representing a 12% increase over the prior peak in 2000. Net revenues grew 40% compared with 2002, primarily attributable to improved Fixed Income and Equities Capital Markets results, which rose $2,398 million or 66% from 2002. Client Services net revenues rose $103 million or 13% from 2002, while Investment Banking net revenues were essentially unchanged from 2002. The Company' s net revenues declined 9% in 2002 compared with 2001 as difficult global market conditions resulted in lower M&A, equity

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

origination and Equity Capital Markets revenues, partially offset by an increase in Fixed Income Capital Markets revenues. Client Services revenues and debt origination revenues remained relatively unchanged in 2002 compared with 2001. See pages 40-46 for a detailed discussion of revenues by segment.

Investment Banking continued to gain market share in key products (specifically, in announced M&A transactions, global equities, convertibles and asset-backed securities), while maintaining a significant share in debt origination. In Fixed Income Capital Markets, the Company continued to grow its client base and significantly improved market share in interest rate derivatives, foreign exchange, corporate and government debt and mortgage-backed securities. In Equity Capital Markets the Company made considerable progress in terms of sales and trading share. In Client Services, the Company continued to introduce new products and services to an expanding client base and completed the acquisition of Neuberger in October 2003.

**Principal Transactions, Commissions and Net Interest Revenues**

In each of its Capital Markets and Client Services businesses, the Company evaluates revenue performance in the aggregate, including Principal transactions, Commissions and net interest. Management of these activities is based on aggregate revenues, which includes an assessment of the potential gain or loss associated with a transaction, including associated commissions, and the interest and dividend revenue or expense associated with financing or hedging positions. Caution should be used when analyzing these revenue categories individually because they may not be indicative of the overall performance of the Capital Markets and Client Services activities.

Principal transactions, Commissions and net interest revenues totaled $6,792 million, $4,339 million and $4,684 million in 2003, 2002 and 2001, respectively. The 57% improvement in 2003 compared with 2002 reflected record revenues from fixed income products and improved equity product revenues. Fixed income products reached record levels in 2003, as historically low interest rates, increased interest rate volatility and narrowing credit spreads drove record customer flow activities. The improved equity product revenues were driven by improvements in the global economy, with stronger corporate earnings and a steady rise in global equity indices. The 7% decline in 2002 from 2001 principally reflects the negative conditions within the global equity markets, which resulted in a decline in Equity Capital Markets revenues, most notably in equity derivatives, as investor concerns regarding corporate governance and geopolitical risks resulted in reduced demand for these products. Equity Capital Markets revenues also were reduced by losses on the Company' s private equity investments in 2002. Despite these negative conditions, the Company improved its market share in both listed and NASDAQ trading volumes. Partially offsetting these revenue declines in 2002 was an increase in Fixed Income Capital Markets revenues, particularly in mortgage products, which benefited from their less credit-sensitive nature and low interest rate levels.

Principal transactions revenue increased $2,329 million or 119% in 2003 compared with 2002, principally reflecting record revenues from fixed income products. Revenues from equity products also improved in 2003 as a result of rising global equity indices and improved performance in private equity. Principal transactions revenue declined $828 million or 30% in 2002 compared with 2001, principally reflecting reduced equity product revenues resulting from poor global market conditions. In addition, Principal transactions revenue declined in 2002 as a result of the transition to a commission-based revenue structure on NASDAQ trades, whereby these revenues are classified as Commissions in 2002 and 2003. In prior years, NASDAQ trades for substantially all institutional customers were transacted on a spread basis, with related revenues classified within Principal transactions.

Commission revenue declined $76 million or 6% in 2003 compared with 2002, primarily reflecting lower trading volumes. Commission revenue grew $195 million or 18% in 2002 compared with 2001 due to the transition to institutional commission-based pricing in the NASDAQ market, growth in market trading volumes and an increase in the Company' s market share of listed and NASDAQ trading volumes.

Interest and dividends revenue and Interest expense are a function of the level and mix of total assets and liabilities (principally financial instruments owned and secured financing activities), the prevailing level of interest rates, and the term structure of the Company' s financings. Interest and dividends revenue and Interest expense are integral components of the overall customer flow activities. The decrease in Interest and dividends revenue and in Interest expense in 2003 and 2002 is principally due to the substantial declines in interest rates during these periods. The 18% increase in net interest revenue to $1,302 million in 2003 from $1,102 million in 2002 was primarily due to an

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

increase in total assets, including higher levels of secured financing activities, and a steeper yield curve in 2003 that reduced interest expense on secured short-term funding. The 35% increase in net interest revenue to $1,102 million



in 2002 from $814 million in 2001 was primarily due to a change in inventory mix to higher levels of interest-bearing assets in response to shifts in customer asset preferences.

**Investment Banking**

Investment banking revenues totaled $1,747 million, $1,771 million and $2,000 million in 2003, 2002 and 2001, respectively. Investment banking revenues result primarily from fees and related revenues earned for underwriting public and private offerings of fixed income and equity securities, advising clients on M&A activities and corporate financing activities. Investment banking revenues of $1,747 million in 2003 were essentially unchanged compared with $1,771 million in 2002, as lower equity underwriting and M&A market volumes were mostly offset by record fixed income underwriting volumes. Industry-wide, global equity market volume declined 2%, while completed M&A advisory market volume was down 17% compared with the already depressed levels of 2002. Fixed income market volume was up 25% compared with 2002. Investment banking revenues declined 11% in 2002 compared with 2001, reflecting significant market weakness in equity underwriting and M&A advisory activities partially offset by improvements in the Company' s market share for completed M&A transactions and underwriting of certain fixed income and equity products (see page 41 for a discussion of the Company' s Investment Banking segment).

## NON-INTEREST EXPENSES

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | Percent Change<br>2003/2002 | <br>2002/2001 |
|---|---|---|---|---|---|
| Compensation and benefits | **$ 4,318** | $ 3,139 | $ 3,437 | 38% | (9)% |
| Non-personnel expenses (excluding the Special Items described below) | **1,716** | 1,517 | 1,424 | 13 | 7 |
| Other real estate reconfiguration charge | **77** | 128 | – | (40) | – |
| September 11th related (recoveries)/ expenses, net | – | (108) | 127 | – | – |
| Regulatory settlement | – | 80 | – | – | – |
| Total non-interest expenses | **$ 6,111** | $ 4,756 | $ 4,988 | 28% | (5)% |
| Compensation and benefits/ Net revenues | **49.9**% | 51.0% | 51.0% | | |

A significant portion of the Company' s expense base is variable, including compensation and benefits, brokerage and clearing, and business development. The Company expects its variable expenses as a percentage of net revenues to remain in approximately the same proportions in future periods.

Non-interest expenses were $6,111 million in 2003, $4,756 million in 2002 and $4,988 million in 2001 and include a number of Special Items. Non-interest expenses in 2003 include a pre-tax real estate charge of $77 million ($45 million after-tax) associated with the Company' s previous decision to dispose of certain excess real estate. Non-interest expenses in 2002 include a pre-tax net gain of $108 million associated with September 11th related costs and insurance settlement proceeds, a $128 million pre-tax charge associated with decisions to reconfigure certain global real estate facilities and an $80 million pre-tax charge related to the settlement of allegations of research analyst conflicts of interest. The 2003 and 2002 real estate-related charges were recognized in accordance with Emerging Issues Task Force ("EITF") Issue No. 94-3, *"Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)."* These charges represent estimated sublease losses expected to be incurred upon exiting certain of the

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Company' s facilities, prinicipally in London and New York. The Company expects that substantially all of such facilities will be subleased by the end of 2004. The net pre-tax effect of these 2002 items is a charge of $100 million ($78 million after-tax). Non-interest expenses in 2001 include a $127 million pre-tax charge ($71 million after-tax) stemming from the events of September 11th, which resulted in the displacement and relocation of substantially all of the Company' s New York based employees. Additional information about these Special Items can be found in Notes 20 and 21 to the Consolidated Financial Statements.

Compensation and benefits expense was $4,318 million, $3,139 million and $3,437 million in 2003, 2002 and 2001, respectively. Compensation and benefits expense as a percentage of net revenues was 49.9% in 2003 and 51.0% in 2002 and 2001. Compensation and benefits expense includes the cost of salaries, bonuses, the amortization of deferred stock compensation awards and employee benefit plans. Variable compensation, consisting primarily of bonuses, increased to $2,283 million in 2003 up from $1,198 million in 2002,



while fixed compensation, consisting primarily of salaries and benefits, increased to $2,035 million in 2003 from $1,941 million in 2002. The increase in fixed compensation primarily resulted from increased salary costs associated with several business acquisitions completed during the year (see "Business Acquisitions") as well as increases in pension expense. Compensation and benefits expense declined 9% in 2002 compared with 2001 commensurate with the 9% decline in Net revenues. Included in compensation and benefits expense is net pension expense/(income) of $45 million, $26 million and $(32) million in 2003, 2002 and 2001, respectively. Amortization of deferred stock compensation awards totaled $625 million, $570 million and $544 million in 2003, 2002 and 2001, respectively.

Non-personnel expenses (excluding the Special Items) were $1,716 million in 2003, up $199 million or 13% compared with $1,517 million in 2002. The increase in non-personnel expenses is principally attributable to increases in occupancy, technology and communications, and brokerage and clearance expenses, as well as the effect of business acquisitions during 2003 (for additional information see Note 6 to the Consolidated Financial Statements). Occupancy expenses increased 11% to $319 million in 2003 from $287 million in 2002 principally attributable to the increased cost of the Company' s new corporate headquarters and additional space needed to accommodate the growth in headcount. Technology and communications expenses were $598 million in 2003 compared with $552 million in 2002, an increase of 8%. The growth reflects amortization of technology assets at new facilities and higher spending associated with the enhancement of capital markets trading platforms and technology infrastructure. Brokerage and clearance expenses rose 12% in 2003 primarily attributable to increased volumes in fixed income products, in addition to the Company' s expansion in equities-related businesses in 2003. Professional fees increased by 22% in 2003 compared with 2002, principally due to higher legal, accounting and audit fees incurred in the current industry environment. In the aggregate, $53 million of non-personnel expenses in 2003 are attributable to business acquisitions. Non-personnel expenses (excluding the Special Items) increased 7% in 2002 from 2001 primarily due to investments in technology and communications, higher occupancy expenses to accommodate headcount growth and the increased cost of the new corporate headquarters, and increased brokerage and clearance expenses due to higher volumes in certain fixed income structured products.

**Income Taxes**

The provision for income taxes totaled $765 million, $368 million and $437 million in 2003, 2002 and 2001, respectively. These provisions resulted in effective tax rates of 30.2%, 26.3% and 25.0%, respectively. The increase in the effective tax rate in 2003 compared with 2002 was primarily due to a higher level of pre-tax income, which reduced the impact of permanent differences, including a decrease in tax-exempt income, partially offset by an increase in tax benefits from foreign operations. The increase in the effective tax rate in 2002 compared with 2001 was primarily due to a less favorable mix of geographic earnings, partially offset by a greater impact of permanent differences, including tax-exempt income. For additional information see Note 19 to the Consolidated Financial Statements.

**Business Acquisitions**

On October 31, 2003, the Company purchased Neuberger as part of the Company' s strategic plan to build out its Client Services segment. This acquisition positions the Company as one of the industry' s leading providers of services to high-net-worth investors, bringing the

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Company’ s assets under management to over $116 billion at November 30, 2003. The Company, with this acquisition, significantly strengthened its Client Services segment and further diversified its revenue base. The Neuberger acquisition strengthened the Company’ s revenues from fee-based activities, allowing for improved cross-cycle performance and reduced earnings volatility. The Company believes this acquisition will provide revenue synergies by (a) making Neuberger products available to the Lehman Brothers network of institutional and high-net worth individual clients in all three geographic regions and (b) offering Neuberger clients an expanded range of investment and risk management products, including structured capital markets products, private equity, and other alternative asset management products. The Company’ s estimated $100 million of revenue and cost synergies of the combined businesses leads the Company to believe that the Neuberger acquisition will be slightly dilutive to earnings per share in 2004 and approximately break even by 2005.

The Company purchased Neuberger for a net purchase price of approximately $2,788 million, including cash consideration and incidental costs of $690 million, equity consideration of $2,374 million (including 32.3 million shares of common stock, 0.3 million shares of restricted common stock and 3.5 million vested stock options) and excluding net cash and short-term investments acquired of $276 million. The Company also issued approximately 0.5 million shares of restricted common stock valued at $42 million, which is subject to future service requirements and will be amortized over the applicable service periods (for additional information see Note 15 to the Consolidated Financial Statements). The Company intends for the Neuberger brand to remain intact. The Neuberger acquisition resulted in an increase of approximately 1,200 employees.

During the second quarter of 2003, the Company acquired a controlling interest in Aurora Loan Services (“ALS”), a residential mortgage loan originator and servicer. The Company believes this acquisition adds long-term value to its mortgage franchise by allowing further vertical integration of the business platform. Mortgage loans originated by ALS are intended to provide a more cost efficient source of loan product for the Company’ s securitization pipeline. The Company also made three



other small acquisitions during 2003. In July 2003, the Company acquired a controlling interest in another residential mortgage loan originator. The strategic objective of this acquisition mirrors that of ALS‑to increase the vertical integration of the Company’ s mortgage business by expanding the pipeline of loan product for securitization. In October 2003, the Company acquired substantially all of the operating assets of The Crossroads Group (“Crossroads”), a diversified private equity fund manager with approximately $2 billion of assets under management. The Crossroads acquisition expanded the Company’ s global private equity franchise to approximately $7 billion under management. In January 2003, the Company acquired the fixed income asset management business of Lincoln Capital Management as part of the Company’ s strategic objective to build out its Client Services segment. The Company’ s headcount increased by approximately 2,200 as a result of these acquisitions. The aggregate total cost of these four acquisitions was approximately $172 million, which was paid in cash and notes. For additional information about these acquisitions, see the Capital Markets and Client Services business segment discussions below and Note 6 to the Consolidated Financial Statements.

## SEGMENTS

The Company operates in three business segments (each of which is described below): Investment Banking, Capital Markets and Client Services. These business activities result in revenues from both institutional and high-net-worth individual clients, which are recognized in all revenue categories in the Consolidated Statement of Income. (Net revenues also contain certain internal allocations, including funding costs, which are centrally managed.) Net revenues from the Company’ s customer flow activities are recorded as either Principal transactions, Commissions or net interest revenues in the Consolidated Statement of Income, depending on the method of execution, financing and/or hedging related to specific inventory positions. In each of its Capital Markets and Client Services businesses, the Company evaluates revenue performance in the aggregate, including Principal transactions, Commissions and net interest. Management of these activities is based on aggregate revenues, which includes an assessment of the potential gain or loss associated with a transaction, including associated commissions, and the interest and dividends revenue and interest expense associated with financing or hedging the Company’ s positions. Caution should be used when analyzing these revenue categories individually because they may not be indicative of the performance of the overall Capital Markets and Client Services activities. The following table summarizes the net revenues of the Company’ s business segments:

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

## BUSINESS SEGMENTS

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | Percent Change<br>2003/2002 | 2002/2001 |
|---|---|---|---|---|---|
| Net revenues: | | | | | |
| Investment Banking | **$ 1,722** | $ 1,731 | $ 1,925 | (1)% | (10)% |
| Capital Markets | **6,018** | 3,620 | 4,024 | 66 | (10) |
| Client Services | **907** | 804 | 787 | 13 | 2 |
| Total net revenues | **8,647** | 6,155 | 6,736 | 40 | (9) |
| Compensation and benefits | **4,318** | 3,139 | 3,437 | 38 | (9) |
| Non-personnel expenses (1) | **1,793** | 1,617 | 1,551 | 11 | 4 |
| Earnings before taxes | **$ 2,536** | $ 1,399 | $ 1,748 | 81% | (20)% |

(1) Non-personnel expenses include special items (the "Special Items") totaling $77 million, $100 million and $127 million in 2003, 2002 and 2001, respectively. Additional information about these Special Items can be found in "Management' s Discussion and Analysis−Results of Operations−Non-Interest Expenses" and in Notes 20, 21 and 22 to the Consolidated Financial Statements. The following business segment discussions do not include the Special Items.



## INVESTMENT BANKING

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | Percent Change<br>2003/2002 | 2002/2001 |
|---|---|---|---|---|---|
| Investment banking net revenues | **$ 1,722** | $ 1,731 | $ 1,925 | (1)% | (10)% |
| Non-interest expenses (1) | **1,321** | 1,321 | 1,552 | − | (15) |
| Earnings before taxes (1) | **$ 401** | $ 410 | $ 373 | (2)% | 10% |

(1) Excludes the effect of Special Items.

The Investment Banking segment provides advice to corporate, institutional and government clients throughout the world on mergers, acquisitions and other financial matters. The segment also raises capital for clients by underwriting public and private offerings of debt and equity securities. The segment is composed of global industry groups−Communications and Media, Consumer/Retailing, Financial Institutions, Financial Sponsors, Healthcare, Industrial, Natural Resources, Power, Real Estate and Technology−that include bankers who deliver industry knowledge to meet clients' objectives. Specialized product groups within Mergers and Acquisitions and Global Finance−which includes Equity Capital Markets, Debt Capital Markets, Leveraged Finance and Private Placements−are partnered with global relationship managers in the global industry groups to provide comprehensive solutions for clients. Specialists in product development and derivatives also are engaged to tailor specific structures for clients.

## INVESTMENT BANKING NET REVENUES

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | Percent Change<br>2003/2002 | 2002/2001 |
|---|---|---|---|---|---|

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | |
|---|---|---|---|---|---|
| Debt Underwriting | **$ 980** | $ 886 | $ 893 | 11% | (1)% |
| Equity Underwriting | **363** | 420 | 440 | (14) | (5) |
| Merger and Acquisition Advisory | **379** | 425 | 592 | (11) | (28) |
| | **$ 1,722** | $ 1,731 | $ 1,925 | (1)% | (10)% |

Net revenues of $1,722 million in 2003 were essentially unchanged from $1,731 million in 2002 as lower equity underwriting and M&A advisory revenues were substantially offset by growth in debt underwriting. Net revenues declined 10% in 2002 to $1,731 million from $1,925 million in 2001 primarily due to lower M&A advisory and equity underwriting revenues.

Debt underwriting revenues increased 11% in 2003 to a record $980 million from $886 million in 2002, as the tightening of credit spreads and a full year of historically low interest rates resulted in record debt underwriting volumes. Industry-wide fixed income origination volume rose 25% from 2002, while the Company' s fixed income origination volume was up 26%. Investment grade and high yield market underwriting volumes were particularly strong as credit spreads tightened 89 basis points and 452 basis points, respectively, from fiscal 2002 levels. The market volume growth in 2003 was largely in high grade debt which generally has lower fee spreads. The Company ranked fourth in market share of worldwide debt underwriting volumes in calendar 2003, up from fifth in calendar 2002 and 2001, with the Company recording market share of 6.9%, 6.9% and 6.4% for the calendar years ended 2003, 2002 and 2001, respectively. Debt underwriting revenues of $886 million in 2002 were essentially unchanged compared with the Company' s 2001 results of $893 million, as issuers continued to take advantage of low interest rates.



Equity underwriting revenues declined 14% in 2003 to $363 million from $420 million in 2002 as industry-wide global equity market volumes declined 2% in fiscal 2003 compared with fiscal 2002. The decline in revenues also is attributable to a change in the mix of equity underwriting, with initial public offerings, which generally are the most lucrative, contributing only 14% of market volume in fiscal 2003, down from 23% in fiscal 2002. The Company increased its global equity-related market share to 3.7% in calendar 2003 from 3.5% in calendar 2002, primarily due to the strong performance in secondary, follow-ons, and convertible offerings globally. Equity origination revenues of $420 million in 2002 declined 5% compared with $440 million in 2001. The Company' s global equity-related market share declined to 3.5% in 2002 from 4.4% in 2001.

M&A advisory fees declined 11% in 2003 to $379 million from $425 million in 2002, as M&A activity remained extremely weak with the market volume for completed transactions in fiscal 2003 reaching its lowest level since 1996. M&A activities continued to be negatively affected by lackluster global growth rates in the first half of 2003, continued weak investor confidence amid geopolitical concerns and uncertainty regarding the global economic recovery. M&A market volume for completed transactions was down 17% compared with fiscal 2002 while the Company' s completed transaction volume was down only 5%. Despite the low volume of activity in fiscal 2003 for completed transactions, M&A activity began to improve in the second half of fiscal 2003, leading to an 8% increase in announced market volume in fiscal 2003 compared with fiscal 2002. The Company' s M&A fee backlog at November 30, 2003 more than doubled from November 30, 2002 indicating an upturn in potential future M&A fee revenue. The Company' s market share for announced transactions was essentially unchanged at 11.0% in calendar 2003 from 10.9% in calendar 2002. M&A advisory fees declined 28% to $425 million in 2002 from $592 million 2001. This decline reflected difficult global market conditions and weak demand for strategic transactions, as corporations remained conservative amid an uncertain business climate. Despite the low volume of activity in the advisory markets, the Company' s market share for completed transactions in calendar 2002 improved to 10.5% compared with 7.4% in calendar 2001.

Non-interest expenses of $1,321 million in 2003 were unchanged from 2002, attributable to a modest increase in compensation and benefits expense reflecting the improved environment at the end of the year, offset by lower business development expense as spending was curtailed in early 2003 when the market environment was subdued. Non-interest expenses in 2002 declined $231 million or 15% compared with 2001, reflecting lower compensation expenses and headcount levels associated with lower revenue and reduced non-personnel-related expenses, particularly business development and professional fees, as the Company focused on minimizing discretionary spending.

Earnings before taxes of $401 million in 2003 declined from $410 million in 2002 driven by the decline in net revenues. Earnings before taxes of $410 million in 2002 increased 10% from 2001 as the 10% decline in net revenues was more than offset by lower expenses.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

## CAPITAL MARKETS

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | Percent Change 2003/2002 | Percent Change 2002/2001 |
|---|---|---|---|---|---|
| Principal transactions | **$ 3,800** | $ 1,474 | $ 2,342 | 158% | (37)% |
| Interest and dividends | **9,903** | 11,691 | 16,371 | (15) | (29) |
| Commissions | **911** | 1,059 | 879 | (14) | 20 |
| Other | **14** | 1 | 13 | – | (92) |
| Total revenues | **14,628** | 14,225 | 19,605 | 3 | (27) |
| Interest expense | **8,610** | 10,605 | 15,581 | (19) | (32) |
| Net revenues | **6,018** | 3,620 | 4,024 | 66 | (10) |
| Non-interest expenses (1) | **4,011** | 2,722 | 2,702 | 47 | 1 |
| Earnings before taxes (1) | **$ 2,007** | $ 898 | $ 1,322 | 123% | (32)% |

(1) Excludes the effect of Special Items.



The Capital Markets segment includes institutional customer flow activities, research, and secondary-trading and financing activities in fixed income and equity products. These products include a wide range of cash, derivative, secured financing and structured instruments and investments. The Company is a leading global market-maker in numerous equity and fixed income products including U.S., European and Asian equities, government and agency securities, money market products, corporate high grade, high yield and emerging market securities, mortgage- and asset-backed securities and real estate, preferred stock, municipal securities, bank loans, foreign exchange, financing and derivative products. The Company is one of the largest investment banks in terms of U.S., and pan-European listed equities trading volume and maintains a major presence in over-the-counter U.S. stocks, major Asian large capitalization stocks, warrants, convertible debentures and preferred issues. The segment also includes the risk arbitrage and secured financing businesses as well as realized and unrealized gains and losses related to private equity investments. The secured financing business manages the Company' s equity and fixed income matched book activities, supplies secured financing to institutional clients and customers, and provides secured funding for the Company' s inventory of equity and fixed income products.

## CAPITAL MARKETS NET REVENUES

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 Gross Revenues | 2003 Interest Expense | 2003 Net Revenues | 2002 Gross Revenues | 2002 Interest Expense | 2002 Net Revenues | 2001 Gross Revenues | 2001 Interest Expense | 2001 Net Revenues |
|---|---|---|---|---|---|---|---|---|---|
| Fixed Income | **$ 10,963** | **$ (6,572)** | **$ 4,391** | $ 10,674 | $ (8,055) | $ 2,619 | $ 13,984 | $ (11,757) | $ 2,227 |
| Equities | **3,665** | **(2,038)** | **1,627** | 3,551 | (2,550) | 1,001 | 5,621 | (3,824) | 1,797 |
| | **$ 14,628** | **$ (8,610)** | **$ 6,018** | $ 14,225 | $ (10,605) | $ 3,620 | $ 19,605 | $ (15,581) | $ 4,024 |

Net revenues of $6,018 million in 2003 rose 66% from 2002, reflecting record fixed income net revenues and a 63% increase in equities net revenues. Net revenues declined $404 million or 10% in 2002 compared with 2001, as a 44% decline in equities net revenues was only partially offset by an 18% improvement in fixed income net revenues.

Fixed income net revenues increased 68% to a record $4,391 million in 2003 from $2,619 million in 2002. Historically low interest rates, significant credit spread tightening, and volatile currency markets all contributed to an extremely favorable environment for fixed income products and record customer flow activities. The Company' s diverse set of fixed income asset classes experienced increased trading

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

volumes that resulted in improved results across a broad range of asset classes including high yield, mortgage, interest rate, and municipal products. High yield products produced record results driven by a combination of strong customer flow activities and improved proprietary position revenues. High yield revenues benefited from the significant tightening of credit spreads, which saw a 452 basis-point tightening during 2003, and improved trading volumes as corporate downgrades were at the lowest level in five years. Record revenues from mortgage-related products were bolstered by robust refinancings and heavy investor demand for newly securitized products, slightly offset by a softening of certain sectors within the commercial real estate market. Refinancings were fueled by historically low interest rates in the U.S. and Europe, with residential refinancings reaching a record high in May 2003. Interest rate products, including derivatives and governments, improved driven by record customer flow activities as issuers and investors sought to diversify and hedge risks. Fixed income net revenues increased $392 million or 18% to $2,619 million in 2002 from $2,227 million in 2001. The increase was principally driven by strong institutional customer flow activity, particularly in mortgage-related products, as secondary flow was aided by strong origination activity and investors sought to minimize risk by moving to more diversified and defensive asset categories. The low interest rate environment throughout 2002 contributed to strong results in the mortgage businesses, principally from increases in securitization transactions and the distribution of various mortgage loan products, which were bolstered by the active refinancing environment. Strong results also were posted in structured credit-related products, particularly in collateralized debt obligations, as clients migrated to products offering diversification and hedging capabilities.



Equities net revenues totaled $1,627 million in 2003, up 63% from 2002 as improvements in the global economy and stronger corporate earnings fueled a steady improvement in global equity indices that began in March and continued through year end. The rise in global equity indices contributed to improved performance in a number of asset classes including derivatives, convertibles, and private equity investments. While U.S. equity trading volumes declined slightly, European and Asian markets experienced a rise in trading volumes contributing to improved performance in these regions. The Company’ s share of NASDAQ market volumes continued to increase to 3.8% in fiscal 2003 from 3.6% in fiscal 2002 and 3.2% in fiscal 2001; however, the Company’ s share of listed NYSE market volumes decreased to 7.0% in fiscal 2003 from 7.2% in fiscal 2002, but remained well above the Company’ s 5.7% share in 2001. The derivative business benefited from improved customer flow activity, particularly in Europe, as customers increasingly used customized derivative products to hedge risk and reduce concentrations. Convertibles revenues were bolstered by improved credit markets and strong customer activity on the heels of increased new issuance activity. The Company recorded net gains on its private equity investments in 2003 compared with losses in 2002. Equities net revenues declined 44% in 2002 to $1,001 million from $1,797 million in 2001 attributable to difficult market conditions that resulted in revenue declines across most equity products including equity derivatives, equity financing and private equity. Equity derivative revenues declined primarily as a result of lower demand for structured equity derivative products. The decline in equity finance revenues was primarily attributable to a decline in customer balances in the prime brokerage business, while private equity investments reported losses on both private and public investments in 2002. These declines were partially offset by improvements in the Company’ s market share in both listed and NASDAQ securities during 2002.

Interest and dividends revenue declined 15% compared with 2002, while Interest expense declined by 19%, primarily reflecting a decline in U.S. interest rates from 2002. Net interest revenue rose 19% to $1,293 million in 2003 principally due to increased total assets, including higher levels of secured financing activities and a steeper yield curve. In 2002 interest and dividends revenue declined 29% while Interest expense declined 32% from 2001, reflecting the significant decline in interest rates during the year. Net interest revenue increased 37% in 2002 compared with 2001 reflecting a steeper yield curve environment and higher interest earning asset levels in 2002 compared with 2001.

Non-interest expenses increased to $4,011 million in 2003 from $2,722 million in 2002, primarily due to an increase in compensation and benefits expense commensurate with the increase in net revenues. Non-personnel expenses increased principally due to higher brokerage and clearance costs associated with higher volumes in certain fixed income products, increased technology and communications expenses associated with the enhancement of capital markets trading platforms, and higher professional fees associated with increased legal, accounting and audit costs. Non-interest expenses were essentially unchanged in 2002 compared with 2001, as lower compensation and benefits expense was offset by higher non-personnel expenses, including increased occupancy costs associated with increased headcount levels and higher technology spending to enhance trading platforms and technology infrastructure.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Earnings before taxes increased to $2,007 million in 2003 from $898 million in 2002 as a 66% increase in net revenues was partially offset by a 47% increase in non-interest expenses. Earnings before taxes of $898 million in 2002 declined 32% from $1,322 million in 2001 primarily due to a 10% decline in net revenues.

In February 2003, the Company acquired a controlling interest in ALS, a residential mortgage loan originator and servicer, and in July 2003 the Company acquired a controlling interest in another residential mortgage loan originator. The Company believes the acquisitions add long-term value to its mortgage franchise by allowing further integration of the business platform. Mortgage loans originated are expected to provide a more cost efficient source of loan product for the Company' s securitization pipeline. (See "Management' s Discussion and Analysis‑Business Acquisitions" on page 39). These acquisitions contributed approximately $238 million of net revenues, $36 million of non-personnel expenses and $59 million of net income in 2003. For additional information see Note 6 to the Consolidated Financial Statements.



## CLIENT SERVICES

| IN MILLIONS | | | | Percent Change | |
|---|---|---|---|---|---|
| YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | 2003/2002 | 2002/2001 |
| Principal transactions | **$ 480** | $ 477 | $ 437 | 1% | 9% |
| Interest and dividends | **39** | 37 | 99 | 5 | (63) |
| Investment banking | **25** | 40 | 75 | (38) | (47) |
| Commissions | **299** | 227 | 212 | 32 | 7 |
| Other | **94** | 44 | 39 | 114 | 13 |
| Total revenues | **937** | 825 | 862 | 14 | (4) |
| Interest expense | **30** | 21 | 75 | 43 | (72) |
| Net revenues | **907** | 804 | 787 | 13 | 2 |
| Non-interest expenses (1) | **702** | 613 | 607 | 15 | 1 |
| Earnings before taxes (1) | **$ 205** | $ 191 | $ 180 | 7% | 6% |

(1) Excludes the effect of Special Items.

The Client Services segment consists of the Private Client and Asset Management business lines. Private Client generates customer-flow transactional revenues from high-net-worth clients, and Asset Management generates fee-based revenues from customized investment management services for high-net-worth clients as well as asset management fees from mutual fund and other institutional investors. Asset Management also generates management and incentive fees from the Company' s role as general partner for private equity and alternative investment partnerships. The Company' s Private Equity business operates in five major asset classes: Merchant Banking, Real Estate, Venture Capital, Fixed Income-related and Third Party Funds.

The Company significantly enhanced its market position in providing asset management services to high-net-worth clients in 2003 through the acquisition of Neuberger. (See "Management' s Discussion and Analysis–Business Acquisitions" on page 39). The Company acquired Neuberger on October 31, 2003, and therefore the Company' s 2003 results reflect only one month of Neuberger' s activity contributing approximately $50 million in net revenues (solely from asset management activities).

## CLIENT SERVICES NET REVENUES

## AND ASSETS UNDER MANAGEMENT

| IN MILLIONS | | | | Percent Change | |
|---|---|---|---|---|---|
| YEAR ENDED NOVEMBER 30 | 2003 | 2002(1) | 2001(1) | 2003/2002 | 2002/2001 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | |
|---|---|---|---|---|---|
| Private Client | $ **766** | $ 714 | $ 667 | 7% | 7% |
| Asset Management | **141** | 90 | 120 | 57 | (25) |
| | $ **907** | $ 804 | $ 787 | 13% | 2% |

(1) Reclassified to conform to the 2003 presentation.

| IN BILLIONS | | | | Percent Change | |
|---|---|---|---|---|---|
| NOVEMBER 30 | 2003 | 2002 | 2001 | 2003/2002 | 2002/2001 |
| Assets under management | $ **116.2** | $ 8.6 | $ 11.7 | – | (26)% |



Client Services net revenues increased $103 million or 13% in 2003 compared with 2002, primarily due to increased revenues associated with the acquisitions of Neuberger, Lincoln Capital Management and Crossroads which contributed $71 million of net revenues in 2003, as well as increased distribution of products to high-net-worth clients. Client Services net revenues rose $17 million or 2% in 2002 compared with 2001 principally due to strong fixed income distribution activity.

Private Client net revenues increased $52 million or 7% in 2003 compared with 2002 reflecting strong fixed income product distribution activities partially offset by lower equity sales, as investors were cautious in the first half of the year before gradually beginning to shift asset allocations in the latter half of the year. Despite the weak equity markets in 2002, Private Client net revenues increased $47 million or 7% in 2002 compared with 2001 driven by strong fixed income activity as high-net-worth clients repositioned their portfolios to more defensive asset classes.

Asset management net revenues increased $51 million or 57% in 2003 compared with 2002 as a result of the acquisitions, partially offset by a decline in Private Equity management fees attributable to the expiration of commitment periods on two of the Company' s funds. Net revenues declined $30 million or 25% in 2002 compared with 2001 primarily as a result of lower Private Equity incentive fees.

Assets under management increased by $108 billion in 2003 compared with 2002 primarily attributable to the acquisitions.

Client Services non-interest expenses of $702 million in 2003 rose $89 million or 15% compared with 2002 primarily due to the acquisitions, coupled with higher compensation and benefits expense related to organic revenue growth. Client Services non-interest expenses of $613 million in 2002 were essentially unchanged from 2001. The acquisitions added approximately 1,400 personnel to the Client Services segment headcount as of November 30, 2003.

Earnings before taxes increased to $205 million in 2003 from $191 million in 2002 as revenue growth outpaced expense growth. Earnings before taxes of $191 million in 2002 improved from $180 million in 2001 as a result of higher revenues.

## GEOGRAPHIC DIVERSIFICATION

### NET REVENUES BY GEOGRAPHIC REGION

| IN MILLIONS | | | | Percent Change | |
|---|---|---|---|---|---|
| YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | 2003/2002 | 2002/2001 |
| Europe | $ **1,864** | $ 1,674 | $ 1,955 | 11% | (14)% |
| Asia Pacific | **875** | 612 | 540 | 43 | 13 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | |
|---|---|---|---|---|---|
| Total International | **2,739** | 2,286 | 2,495 | 20 | (8) |
| U.S. | **5,908** | 3,869 | 4,241 | 53 | (9) |
| Total | **$ 8,647** | $ 6,155 | $ 6,736 | 40% | (9)% |

International net revenues were $2,739 million, $2,286 million and $2,495 million in 2003, 2002 and 2001, respectively, representing approximately 32% of total net revenues in 2003 and 37% in both 2002 and 2001. International net revenues grew 20% in 2003 compared with 2002 and declined 8% in 2002 compared with 2001.

Net revenues in Europe increased 11% to $1,864 million in 2003 from $1,674 million in 2002 attributable to improvements in the capital markets environment, primarily equities, driven by increased customer flow activity in derivative and convertible products. Investment banking revenue grew, driven by increased activity in debt and equity origination. These improvements were partially offset by declines in fixed income capital markets revenues due to a softening of certain sectors within the commercial real estate markets and in M&A. Net revenues declined 14% in 2002 compared with 2001 attributable to a significant decline in equity capital markets and investment banking net revenues due to low corporate demand for equity derivative products and a decline in the European equity origination markets. These declines were partially offset by growth in the fixed income capital markets business, which experienced a record year driven by growth in structured transactions as well as strong performance in interest rate and mortgage-related products.

Net revenues in Asia Pacific of $875 million in 2003 increased 43% from $612 million in 2002 attributable to improved performance in fixed income and equities capital markets and investment banking results. Fixed income capital markets revenue increased primarily due to



a higher level of activity in interest rate products. Equities capital markets revenue growth was driven by strength in derivatives corresponding with the increase in the Nikkei. Investment banking revenue also grew, driven by the Company’ s improved position in advisory activity, where completed M&A market share improved to 12.3% in calendar 2003 compared with 4.7% in calendar 2002. Asia Capital Markets and Investment Banking partnered together to deliver solutions to regional clients that included the resolution of non-performing loan portfolios, innovative capital raising and price hedging of a portfolio of cross shareholdings, consistent with the Company’ s primary strategic theme for the Asia region of delivering the restructuring capabilities of the Company to regional clients. Net revenues increased $72 million or 13% in 2002 compared with 2001. Growth in the fixed income capital markets business in 2002 was driven by strength in derivatives, high yield and mortgage-related products as a result of strong customer flow activities and new transactions, particularly in the distressed asset securitization business. This performance was partially offset by a decline in equity capital markets and investment banking net revenues due to a lack of corporate demand for equity derivatives, depressed equity markets and poor market conditions in the investment banking environment.

## LIQUIDITY, FUNDING AND CAPITAL RESOURCES

The Company’ s Finance Committee is responsible for developing, implementing and enforcing its liquidity, funding and capital policies. These policies include recommendations for capital and balance sheet size as well as the allocation of capital and balance sheet to the business units. Through the establishment and enforcement of capital and funding limits, the Finance Committee oversees compliance with policies and limits throughout the Company with the goal of ensuring the Company is not exposed to undue funding or liquidity risk.

### Liquidity Risk Management

Liquidity and liquidity management are of critical importance to the Company. The Company’ s funding strategy seeks to ensure the Company maintains sufficient liquid financial resources to continually fund its balance sheet and meet all of its funding obligations in all market environments. The strategy is based on the following principles:

Liquidity providers are credit and market sensitive and quick to react to any perceived market or firm-specific risks. Consequently, the Company remains in a state of constant liquidity readiness.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

During a liquidity event, certain secured lenders will require higher quality collateral, resulting in a lower availability of secured funding for "hard-to-fund" asset classes. Consequently, the Company only relies on secured funding to the extent it believes it would be available in all market environments.

A firm' s legal entity structure may constrain liquidity. Some regulators or rating agency considerations may prevent the free flow of funds between the subsidiaries they supervise ("Restricted Subsidiaries") and Holdings and its other subsidiaries ("Unrestricted Subsidiaries"). Consequently, the Company seeks to ensure that the Restricted Subsidiaries on the one hand, and Holdings and its Unrestricted Subsidiaries collectively on the other, have sufficient "stand alone" liquidity and that there is no "cross subsidization" of liquidity from these Restricted Subsidiaries to Holdings and its Unrestricted Subsidiaries.

For planning purposes, the Company does not assume that, in a liquidity crisis, assets can be sold to generate cash, unsecured debt can be issued or any cash and unencumbered liquid collateral outside of the liquidity pool can be used to support the liquidity of Holdings and the Unrestricted Subsidiaries.

When managing liquidity, the Company pays particularly close attention to the size of its liquidity pool, its long-term funding sources and requirements and its reliable secured funding capacity. Each of these metrics is explained in more detail below.

***Liquidity Pool*** The Firm' s policy is to maintain a sizable liquidity pool for Holdings and its Unrestricted Subsidiaries that covers all expected cash outflows in a stressed liquidity environment for one year without being able to access the unsecured debt market. This liquidity pool is invested in cash and unencumbered liquid collateral such as U.S. government and agency obligations, investment grade securities and index equities that can be monetized at short notice in all market environments to provide liquidity to Holdings, which issues most of the unsecured debt. At November 30, 2003 the estimated pledge value of this portfolio, along with the undrawn portion of Holdings' committed credit facility (see "Credit Facilities" on page 51), totaled approximately $16.3 billion. Cash and unencumbered liquid assets that are presumed to be "trapped" in a Restricted Subsidiary or required for operational purposes are not counted as available liquidity to Holdings and the Unrestricted Subsidiaries.

The Company' s liquidity pool is expected to be available to cover expected cash outflows in a stressed liquidity environment including:

The repayment of all unsecured debt of Holdings and the Unrestricted Subsidiaries maturing within twelve months.

The drawdown of commitments to extend credit made by Holdings and the Unrestricted Subsidiaries based on an analysis of the probability of such drawdown (see "Summary of Contractual Obligations and Commitments−Lending-Related Commitments" on page 53).

Additional collateralization of derivative contracts and other secured funding arrangements by Holdings and the Unrestricted Subsidiaries to counterparties that would be required in the event of a lowering of debt ratings (see "Credit Ratings" on page 52).



---

Continuing equity repurchases to offset the dilutive effect of the Company' s employee incentive plans (see "Stock Repurchase Plan" on page 52) and anticipated debt repurchases.

These projected outflows are re-assessed weekly and as they change, management adjusts the size requirement for the liquidity pool.

The liquidity of the Restricted Subsidiaries is separately managed to comply with their applicable liquidity and capital requirements and to minimize dependence on Holdings and the Unrestricted Subsidiaries.

***Long-Term Funding Sources and Requirements*** Cash capital is the metric used by management to assess the long-term funding sources and requirements of the Company as a whole. The Company' s policy is to operate with an excess of long-term funding sources over its consolidated long-term funding requirements.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In 2003, the Company added materially to its cash capital sources (i.e., total stockholders' equity, preferred securities subject to mandatory redemption and long-term debt excluding current portion, other liabilities with remaining terms greater than one year and deposit liabilities at the Company's banking institutions, Lehman Brothers Bank, FSB ("LBB") and Lehman Brothers Bank AG ("LBBAG"), which are considered to be core in nature). The Company also considers the undrawn portion of its committed facilities at Holdings and LBBAG as a source of cash capital (see "Credit Facilities" on page 51).

At November 30, 2003, the Company had raised more than $64 billion of cash capital across all its legal entities−the majority of it through long-term debt. Sources of cash capital at November 30 were as follows:

**CASH CAPITAL SOURCES**

| IN BILLIONS<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| Total stockholders' equity and preferred securities subject to mandatory redemption | $ **14** | $ 10 |
| Long-term debt, excluding current portion | **36** | 31 |
| Deposit liabilities at LBB and LBBAG | **8** | 3 |
| Other long-term secured obligations | **4** | 4 |
| Undrawn portion of unsecured committed facilities at Holdings and LBBAG | **2** | 1 |
| Total cash capital sources | $ **64** | $ 49 |

Cash capital is used to fund the following long-term funding requirements:

Less liquid assets, such as fixed assets and goodwill.

Less liquid inventory, such as high yield loans, private equity investments, commercial mortgages and certain real estate positions.

Unencumbered inventory irrespective of collateral quality.

Secured funding "haircuts" (i.e., the difference between the market value of the available inventory and the value of cash advanced to the Company by counterparties against that inventory).

Operational cash deposited by the Company at banks.

Liquid investments held to fund certain projected cash outflow as described in "Liquidity Pool" on page 47. These investments are managed as part of the Liquidity Pool.

The Company also utilizes LBB and LBBAG to fund certain asset classes such as mortgage products and selected loan assets. These entities operate in a deposit-protected environment and are able to source low-cost unsecured funds that generally are insulated from a Company or market-specific event, thereby providing a reliable funding source for these asset classes.



At November 30, 2003, the Company had an $11 billion cash capital surplus across all legal entities. Cash capital sources and uses at November 30 are as follows:

**CASH CAPITAL SURPLUS**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| IN BILLIONS NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| Cash capital sources | $ 64 | $ 49 |
| Cash capital uses: | | |
| Trading and trading-related assets | 42 | 35 |
| Non-trading assets | 11 | 8 |
| Total cash capital uses | 53 | 43 |
| Cash capital surplus | $ 11 | $ 6 |

Cash capital surplus, which is part of the various liquidity pools of the Company, increased $5 billion in 2003 from $6 billion to $11 billion. Of the $11 billion in cash capital surplus, $6 billion is available to Holdings and its Unrestricted Subsidiaries. The Company targets maintaining a cash capital surplus available to Holdings and its Unrestricted Subsidiaries of not less than $2 billion.

***Reliable Secured Funding Capacity*** The Company takes what management believes is a conservative approach to secured funding by depending on it only to the extent it is reliable in all market environments. The Company regularly performs a detailed assessment of its secured funding capacity by asset class and by counterparty to determine how much is reliable in a stressed liquidity environment. Reliable secured funding capacity is usually set at a significant discount to normal funding capacity. In particular, less liquid inventory such as high yield loans and commercial mortgages are funded entirely with cash capital−any short-term secured funding that might exist for these asset classes in a normal market environment is not considered to be reliable.

The Company has developed and regularly updates its Contingency Funding Plan, which represents a detailed action plan to manage a stressed liquidity event, including a communication plan for creditors, investors and clients during a funding crisis.

The liquidity policies and funding strategy discussed above have enabled the Company to build a strong liquidity position, which has played an important role in the narrowing of its credit spreads relative to its major competitors and in its credit ratings being raised by rating agencies. (See “Credit Ratings” on page 52).

**Funding and Capital Resources**

**TOTAL CAPITAL**

| IN MILLIONS NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| Long-term debt: | | |
| Senior notes | $ 41,303 | $ 36,283 |
| Subordinated indebtedness | 2,226 | 2,395 |
| Subtotal | 43,529 | 38,678 |
| Preferred securities subject to mandatory redemption | 1,310 | 710 |
| Stockholders’ equity: | | |
| Preferred stockholders’ equity | 1,045 | 700 |
| Common stockholders’ equity | 12,129 | 8,242 |
| Subtotal | 13,174 | 8,942 |
| Total Capital | $ 58,013 | $ 48,330 |

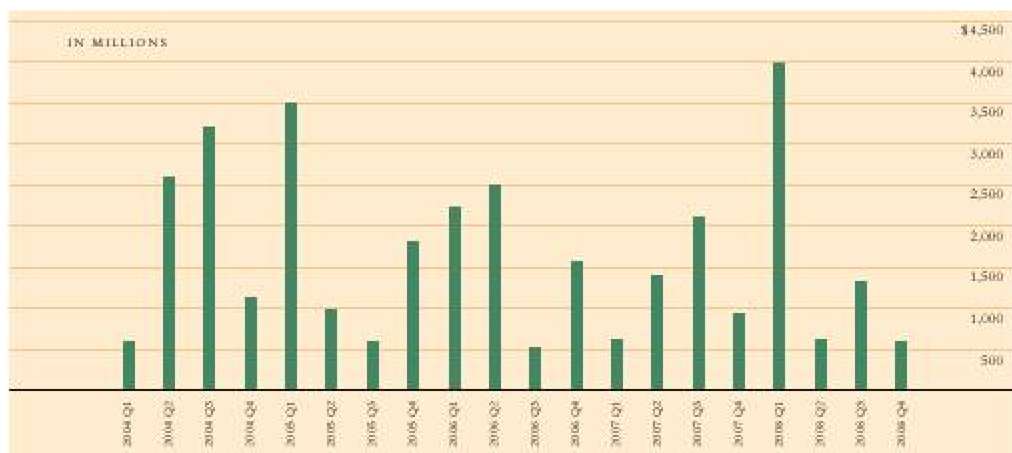
The Company’s Total Capital (defined as long-term debt, preferred securities subject to mandatory redemption and total stockholders’ equity) increased 20% to $58.0 billion at November 30, 2003 compared with $48.3 billion at November 30, 2002. The Company believes Total Capital is useful to investors as a measure of the Company’s financial strength because it aggregates the Company’s long-term funding sources. The increase in Total Capital principally resulted from a net increase in long-term debt and increased equity from the retention of earnings and the issuance of common stock to acquire Neuberger.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company actively manages long-term debt to minimize refinancing risk and investor concentration. The Company sets limits for the amount maturing over any three, six and twelve month horizon at 10%, 15% and 25% of outstanding long-term debt, respectively−that is, $4.4 billion, $6.5 billion and $10.9 billion, respectively, at November 30, 2003. The Company seeks to diversify its creditor base when issuing unsecured debt. The quarterly long-term debt maturity schedule over the next five years at November 30, 2003 is as follows:



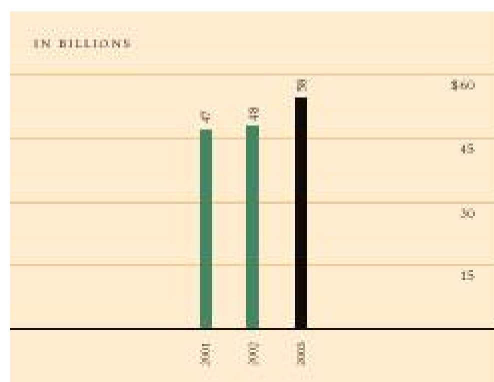
**LONG-TERM DEBT MATURITY PROFILE**




During 2003, the Company issued $13,193 million in senior long-term debt securities and $190 million of subordinated long-term debt, which was $3,246 million in excess of maturing debt securities consisting of $9,815 million of senior notes and $322 million of subordinated notes. Long-term debt increased to $43.5 billion at November 30, 2003 from $38.7 billion at November 30, 2002 with a weighted-average maturity of 3.9 years at November 30, 2003 and 4.0 years at November 30, 2002.

In addition, the Company issued $345 million of 6.50% Cumulative Preferred Stock in 2003. Holdings may redeem the preferred stock on or after August 31, 2008. For additional information see Note 13 to the Consolidated Financial Statements. Also in 2003, the Company formed two trusts to issue $600 million of 6.38% preferred securities subject to mandatory redemption, maturing in 2052 and redeemable beginning in 2008. See Note 12 to the Consolidated Financial Statements for additional information about Preferred securities subject to mandatory redemption.

**TOTAL CAPITAL**






Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

### Credit Facilities

Holdings maintains a revolving credit agreement (the "Credit Agreement") with a syndicate of banks. Under the Credit Agreement, the banks have committed to provide up to $1 billion through April 2005. The Credit Agreement contains covenants that require, among other things, that the Company maintain a specified level of tangible net worth. The Company also maintains a $750 million multi-currency revolving credit facility for LBBAG (the "Facility"). The Facility has a term of 364 days expiring in October 2004, with an option to extend payment for an additional 364 days. There were no borrowings outstanding under either the Credit Agreement or the Facility at November 30, 2003, although drawings have been made under both and repaid from time to time during the year. The Company has maintained compliance with the applicable covenants for both the Credit Agreement and the Facility at all times.

### Cash Flows

The Company generated cash from operating activities of $2,547 million in 2003, as cash from earnings and operating assets and liabilities exceed cash utilized in secured financing activities. During 2003 the Company increased cash by $4,223 million overall as cash flows from operating and financing activities of $5,331 million, exceed cash utilized in investing activities of $1,108 million.

During 2002 the Company increased cash by $1,138 million as cash flows from operating activities of $6,017 million exceed cash utilized in financing and investing activities of $4,344 million and $535 million, respectively. During 2001 the Company utilized cash of $2,599 million as cash utilized in financing activities and investing activities of $1,559 million and $1,341 million, respectively, exceed cash provided by operating activities of $301 million.

### Balance Sheet and Financial Leverage

***Assets*** The Company' s balance sheet consists primarily of cash and cash equivalents, securities and other inventory positions owned, and collateralized financing agreements. The liquid nature of these assets provides the Company with flexibility in financing and managing its business. The majority of these assets are funded on a secured basis through collateralized financing agreements.

The Company' s total assets increased to $312 billion at November 30, 2003 from $260 billion at November 30, 2002. However, the Company believes net assets is a more meaningful measure when comparing companies in the securities industry because it excludes certain assets considered to have a low risk profile (securities purchased under agreements to resell, securities borrowed, and the collateral received recognized in inventory pursuant to Statement of Financial Accounting Standards No. 140, *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities–a replacement of SFAS No. 125" ("SFAS 140"),* as well as goodwill and other identifiable intangible assets). This definition of net assets is used by many of the Company' s creditors and a leading rating agency to evaluate companies in the securities industry. Under this definition, net assets were $166 billion and $143 billion at November 30, 2003 and 2002, respectively, as follows:

**NET ASSETS**

| IN MILLIONS<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| Total assets | **$ 312,061** | $ 260,336 |
| Securities purchased under agreements to resell | **(87,416)** | (94,341) |
| Securities borrowed | **(51,396)** | (20,497) |
| Collateral received recognized in inventory pursuant to SFAS 140 | **(3,406)** | (1,994) |
| Identifiable intangible assets and goodwill | **(3,561)** | (213) |
| Net assets | **$ 166,282** | $ 143,291 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company' s net assets consist primarily of inventory necessary to facilitate customer flow activities. As such, the Company' s mix of net assets is subject to change depending principally on customer demand. In addition, due to the nature of the Company' s customer flow activities and based on the Company' s business outlook, the overall size of the Company' s balance sheet will fluctuate from time to time and, at specific points in time, may be higher than the year-end or quarter-end amounts.

The $51.7 billion increase in gross assets at November 30, 2003 was primarily due to an increase in secured financing activities. Net assets at November 30, 2003 increased $23.0 billion compared with 2002, primarily due to the increase in the level of government and agency securities, mortgages and mortgage-backed securities, corporate debt and cash and cash equivalents.



***Leverage Ratios*** Balance sheet leverage ratios are one measure used to evaluate the capital adequacy of a company. Gross leverage ratios are calculated as total assets divided by total stockholders' equity. The Company' s gross leverage ratios were 23.7x and 29.1x at November 30, 2003 and 2002, respectively. However, the Company believes net leverage based on net assets as defined above (which excludes certain assets considered to have a low risk profile) divided by tangible equity capital, to be a more meaningful measure of leverage in evaluating companies in the securities industry. The Company believes tangible equity capital to be a more representative measure of the Company' s equity for purposes of calculating net leverage because the Company does not view the amount of equity used to support goodwill and other identifiable intangible assets as available to support the Company' s net assets. This definition of net leverage is used by many of the Company' s creditors and a leading rating agency. Tangible equity capital and net leverage are computed as follows at November 30, 2003 and 2002:

| IN MILLIONS<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| Total stockholders' equity | **$ 13,174** | $ 8,942 |
| Preferred securities subject to mandatory redemption (subject to limitation)(1) | **1,068** | 710 |
| Identifiable intangible assets and goodwill | **(3,561)** | (213) |
| Tangible equity capital | **$ 10,681** | $ 9,439 |
| Net leverage | **15.6x** | 15.2x |

(1) Under the definition of tangible equity capital used by a leading rating agency, the maximum equity credit given to preferred securities subject to mandatory redemption is 10% of tangible equity capital (preferred securities are included in calculation to determine the limit). In October 2003, in view of the favorable market conditions, the Company issued $300 million of preferred securities subject to mandatory redemption at 6.375% in anticipation of calling $325 million of preferred securities subject to mandatory redemption at 8% in March 2004, thereby lowering interest expense for the Company over the long run.

Net assets, tangible equity capital and net leverage are not necessarily comparable to similarly titled measures provided by other companies because of different methods of calculation.

**Stock Repurchase Plan**

The management of equity is a critical aspect of capital management in any business. The determination of the appropriate amount of equity is affected by a wide number of factors. The primary factor is the amount of "risk equity" that the businesses require, although other factors, such as rating agency considerations and balance sheet leverage, will also affect the determination. Equity requirements are constantly changing and the Company' s Risk Management Group monitors the Firm' s risk requirements on an active basis.

The principal purpose of the Firm' s stock repurchase program is to substantially offset the dilutive effect of employee equity-based compensation. In addition, the Firm may repurchase shares representing "surplus equity" (equity not being utilized by the businesses or required by the Firm for risk equity or other strategic purposes). The repurchase program is effected through regular open-market purchases.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

During 2003, the Company repurchased approximately 23.1 million shares of Holdings common stock at an aggregate cost of approximately $1,508 million. The Company repurchased approximately 5.0 million, 4.5 million, 4.3 million and 9.3 million shares in the first, second, third and fourth quarters of 2003, respectively. The average price paid per share for repurchased shares in the first, second, third and fourth quarters was $54.74, $61.10, $67.26 and $71.81, respectively. For 2004, the Board of Directors has authorized the repurchase of approximately 26.7 million shares of common stock to offset projected 2004 dilution and, subject to market conditions, up to an additional 35.1 million shares, primarily for the possible acceleration of projected 2005 requirements to offset dilution, as well as to manage the Company' s common equity position.

**Credit Ratings**

The Company, like other companies in the securities industry, relies on external sources to finance a significant portion of its day-to-day operations. The cost and availability of unsecured financing generally are dependent on the Company' s short-term and long-term credit ratings. Factors that may be significant to the determination of the Company' s credit ratings or otherwise affect the ability of the Company to raise short-term and long-term financing include its profit margin, its earnings trend and volatility, its cash liquidity and liquidity management, its capital structure, its risk level and risk management, its geographic and business diversification, and its relative positions in the markets in which it operates. A deterioration in any of the previously mentioned factors or combination of these factors may lead rating agencies to downgrade the credit ratings of the Company, thereby increasing the cost to the Company of, or possibly limiting the access of the Company



to, certain types of unsecured financings and triggering additional collateral requirements in derivative contracts and other secured funding arrangements. In addition, the Company' s debt ratings can impact certain capital markets revenues, particularly in those businesses where longer-term counterparty performance is critical, such as over-the-counter ("OTC") derivative transactions, including credit derivatives and interest rate swaps.

At November 30, 2003, the Company would be required to post additional collateral pursuant to derivative contracts and other secured funding arrangements of approximately $658 million in the event the Company were to experience a downgrade of its senior debt rating of one notch.

At November 30, 2003, the short- and long-term debt ratings of Holdings and Lehman Brothers Inc. ("LBI") were as follows:

**CREDIT RATINGS**

| | Holdings | | LBI | |
|---|---|---|---|---|
| | Short-term | Long-term | Short-term | Long-term** |
| Fitch Ratings | F-1 | A+ | F-1 | A+/A |
| Moody' s Investors Service(1) | P-1 | A1 | P-1 | Aa3*/A1 |
| Standard & Poor' s Ratings Services | A-1 | A | A-1 | A+*/A |

* Provisional ratings on shelf registration.

** Senior/subordinated.

(1) On October 22, 2003, Moody' s raised the long-term rating of Holdings and LBI from A2 to A1 and from A1 to Aa3, respectively. Since 1999, Moody' s has raised the long-term ratings of Holdings and LBI three times; from Baa1 to A1 and from A3 to Aa3, respectively.

**SUMMARY OF CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In the normal course of business, the Company enters into various commitments and guarantees, including lending commitments to high grade and high yield borrowers, private equity investment commitments, liquidity commitments and other guarantees. In all instances, the Company marks-to-market these commitments and guarantees, with changes in fair value recognized in Principal transactions revenue.

***Lending-Related Commitments*** In connection with its financing activities, the Company had outstanding commitments under certain collateralized lending arrangements of approximately $5.0 billion and $1.5 billion at November 30, 2003 and 2002, respectively. These commitments require borrowers to provide acceptable collateral, as defined in the agreements, when amounts are drawn under the lending facilities. Advances made under these lending arrangements are typically at variable interest rates and generally provide for over-collateralization based on the borrowers' creditworthiness. In addition, at November 30, 2003, the Company had commitments to enter into forward starting secured resale and repurchase agreements, principally secured by government and government agency collateral, of $78.4 billion and $46.2 billion, respectively, compared with $89.9 billion and $50.3 billion, respectively, at November 30, 2002.

The Company, through its high grade and high yield sales, trading and underwriting activities, makes commitments to extend credit in loan syndication transactions. The Company uses various hedging and funding strategies to actively manage its market, credit and liquidity exposures on these commitments. In addition, total commitments are not indicative of actual risk or funding requirements, as the commitments may not be drawn or fully used. These commitments and any related draw downs of these facilities, typically have fixed maturity dates and are contingent upon certain representations, warranties and contractual conditions applicable to the borrower.

The Company had credit risk associated with lending commitments to investment grade borrowers (after consideration of credit risk hedges) of $3.0 billion and $3.2 billion at November 30, 2003 and 2002, respectively. In addition, the Company had credit risk associated with lending commitments to non-investment grade borrowers (after consideration of credit risk hedges) of $2.6 billion and $1.7 billion at November 30, 2003 and 2002, respectively. Before consideration of credit risk hedges, the Company had commitments to investment and non-investment grade borrowers of $8.1 billion and $2.9 billion at November 30, 2003, respectively, compared with $7.1 billion and $1.8 billion at November 30, 2002, respectively. The Company had available undrawn borrowing facilities with third parties of approximately $5.1 billion and $5.2 billion at November 30, 2003 and 2002, respectively, which can be drawn upon to provide funding for these commitments. These funding facilities contain limits for certain concentrations of counterparty, industry or credit ratings of the underlying loans.

In addition, the Company provided high yield contingent commitments related to acquisition financing of approximately $2.5 billion and $2.8 billion at November 30, 2003 and 2002, respectively. The Company' s intent is, and its past practice has been, to sell down significantly all the credit risk associated with these loans, if closed, through loan syndications consistent with the Company' s credit facilitation framework. These commitments are not indicative of the Company' s actual risk because the borrower often will raise funds in the capital markets instead of drawing on the Company' s commitment. Additionally, the borrower' s ability to draw is subject to there being no material adverse change in either market conditions or the borrower' s financial condition, among other factors. These commitments contain certain flexible pricing features to adjust for changing market conditions prior to closing.



At November 30, 2003 the Company had outstanding mortgage loan commitments of approximately $3.1 billion, including $2.6 billion of residential mortgages and $0.5 billion of commercial mortgages. These commitments require the Company to transact mortgage loans generally within 90 days at fixed and variable interest rates. The Company intends to sell such loans, once originated, through securitization.

Aggregate lending related commitments at November 30, 2003, before consideration of hedges, by maturity are as follows:

**LENDING - RELATED COMMITMENTS**

| Total | Amount of Commitment Expiration Per Period |
|---|---|

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| IN MILLIONS NOVEMBER 30, 2003 | Contractual Amount | Less than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
|---|---|---|---|---|---|
| Lending commitments: | | | | | |
| High grade | $ **8,137(1)** | $ **4,615** | $ **2,911** | $ **611** | $ **–** |
| High yield | **2,857(2)** | **889** | **938** | **566** | **464** |
| Mortgage commitments | **3,121** | **3,121** | **–** | **–** | **–** |
| Contingent acquisition facilities | **2,549** | **2,549** | **–** | **–** | **–** |
| Secured lending transactions, including forward starting resale and repurchase agreements | **129,625** | **119,445** | **9,256** | **140** | **784** |

(1) The Company views its net credit exposure for high grade commitments, after consideration of hedges, to be $3.0 billion.

(2) The Company views its net credit exposure for high yield commitments, after consideration of hedges, to be $2.6 billion.

For additional information see Note 11 to the Consolidated Financial Statements.

***Other Commitments and Guarantees*** In accordance with Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 45, *"Guarantor' s Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of Indebtedness of Others"* ("FIN 45") the Company is required to recognize certain guarantee contracts at the inception of such guarantee contract at fair value. The Company has followed a long-standing policy of recording guarantees, including derivative guarantees, at fair value and, accordingly, the adoption of FIN 45 did not affect the Company' s financial position or results of operations. In accordance with FIN 45, the Company also is required to disclose certain guarantees, including derivative contracts that require the Company to make payments to a counterparty based on changes on an underlying instrument or index (e.g., security prices, interest rates, and currency rates). Derivatives that meet the FIN 45 definition of a guarantee include credit default swaps, written put options, written foreign exchange options and written interest rate caps and floors. Under FIN 45, derivatives are not considered guarantees if such contracts are cash settled and the Company has no basis to determine whether it is probable the derivative counterparty held the related underlying instrument. Accordingly, if these conditions are met, the Company has not included such derivative contracts in the table on page 55.

At November 30, 2003, the maximum payout value of derivative contracts deemed to meet the FIN 45 definition of a guarantee was approximately $322 billion. For purposes of determining maximum payout, notional values were used; however, the Company believes the fair value of these contracts is a more relevant measure of these obligations. At November 30, 2003, the fair value of such derivative contracts approximated $9 billion. The Company believes the notional amounts greatly overstate the Company' s expected payout. For a discussion of the valuation of derivative contracts, see "Critical Accounting Policies and Estimates−Derivatives" on page 62. In addition, all amounts included above are before consideration of hedging transactions. These derivative contracts are generally highly liquid and the Company has substantially mitigated its risk on these contracts through hedges, such as other derivative contracts and/or cash instruments. The Company manages risk associated with derivative guarantees consistent with the Company' s global risk management policies. The Company records derivative contracts, including those considered to be guarantees under FIN 45, at fair value with related gains/losses recognized in Principal transactions revenue. See "Risk Management−Market Risk" and "Critical Accounting Policies and Estimates−Fair Value" on page 59 and 61, respectively.



At November 30, 2003, the Company had liquidity commitments of approximately $5.1 billion related to trust certificates backed by investment grade municipal securities compared with $4.4 billion at November 30, 2002. The Company' s obligations under such liquidity commitments generally are less than one year and are further limited because the Company' s obligations cease if the underlying assets are downgraded below investment grade or default.

At November 30, 2003 and 2002 the Company was contingently liable for $913 million and $835 million, respectively, of letters of credit, primarily used to provide collateral for securities and commodities borrowed and to satisfy margin deposits at option and commodity exchanges.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

At November 30, 2003 and 2002 the Company had private equity commitments of approximately $382 million and $672 million, respectively. The Company' s private equity commitment of $382 million at November 30, 2003 will be funded as required through the end of the respective investment periods. In addition, the Company was committed to invest up to $170 million in an energy-related principal investment at November 30, 2003.

In the normal course of business, the Company provides guarantees to securities clearinghouses and exchanges. These guarantees are generally required under the standard membership agreements, such that members are required to guarantee the performance of other members. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. The Company' s obligation under such guarantees could exceed the collateral amounts posted; however, the potential for the Company to be required to make payments under such guarantees is deemed remote.

In connection with certain asset sales and securitization transactions, the Company often makes representations and warranties about the assets conforming to specified guidelines. If it is later determined the underlying assets fail to conform to the specified guidelines, the Company may have an obligation to repurchase the assets or indemnify the purchaser against any losses. To mitigate these risks, to the extent the assets being securitized may have been originated by third parties, the Company seeks to obtain appropriate representations and warranties from these third parties upon acquisition of such assets.

Other commitments and guarantees at November 30, 2003 are as follows:

**COMMITMENTS AND GUARANTEES**

| IN MILLIONS NOVEMBER 30, 2003 | Notional/ Maximum Payout | Amount of Commitment Expiration Per Period Less than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
|---|---|---|---|---|---|
| Derivative contracts | $ 321,550 | $ 66,013 | $ 76,639 | $ 38,400 | $ 140,498 |
| Municipal-securities-related liquidity commitments | 5,130 | 3,186 | 42 | 94 | 1,808 |
| Other commitments and guarantees associated with other special purpose entities | 2,510 | 750 | 346 | 603 | 811 |
| Standby letters of credit | 913 | 906 | 7 | – | – |
| Private equity and other principal investment commitments | 552 | 212 | 340 | – | – |

Contractual obligations at November 30, 2003 are as follows:

| IN MILLIONS NOVEMBER 30, 2003 | Total | Amount of Obligation Expiration per Period Less than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
|---|---|---|---|---|---|
| Operating lease obligations | $ 2,166 | $ 185 | $ 509 | $ 312 | $ 1,160 |
| Capital lease obligations | 2,661 | – | 161 | 134 | 2,366 |
| Long-term debt maturities | 43,529 | 7,644 | 18,787 | 8,810 | 8,288 |



**OFF-BALANCE SHEET ARRANGEMENTS**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In the normal course of business, the Company enters into derivative transactions both in a trading capacity and as an end-user.

As an end-user, the Company uses derivative products to adjust the interest rate nature of its funding sources from fixed to floating interest rates and to change the index upon which floating interest rates are based (e.g., Prime to LIBOR) (collectively, "End-User Derivative Activities"). For additional information see Note 3 to the Consolidated Financial Statements.

The Company uses derivative products in a trading capacity as a dealer to satisfy the financial needs of clients and in each of its trading businesses (collectively, "Trading-Related Derivative Activities"). In this capacity the Company transacts extensively in derivatives including interest rate, credit (both single name and portfolio), foreign exchange and equity derivatives. The Company' s use of derivative products in its trading businesses is combined with transactions in cash instruments to allow for the execution of various trading strategies.

The Company conducts its derivative activities through a number of wholly-owned subsidiaries. The Company' s fixed income derivative products business is conducted through its subsidiary, Lehman Brothers Special Financing Inc., and separately capitalized "AAA" rated subsidiaries, Lehman Brothers Financial Products Inc. and Lehman Brothers Derivative Products Inc. The Company' s equity derivative product business is conducted through Lehman Brothers Finance S.A. In addition, as a global investment bank, the Company also is a market maker in a number of foreign currencies and actively trades in the global commodity markets. Counterparties to the Company' s derivative product transactions are primarily financial intermediaries (U.S. and foreign banks), securities firms, corporations, governments and their agencies, finance companies, insurance companies, investment companies and pension funds. The Company manages the risks associated with derivatives on an aggregate basis, along with the risks associated with its non-derivative trading and market-making activities in cash instruments, as part of its firmwide risk management policies. The Company uses industry standard derivative contracts whenever appropriate.

See Notes 1 and 3 to the Consolidated Financial Statements for a description of the Company' s accounting policies and further discussion of the Company' s Trading-Related Derivative Activities.

**Other Off-Balance Sheet Arrangements**

***Operating Companies*** FASB Interpretation No. 46, Consolidation of Variable Interest Entities − an interpretation of ARB No. 51, ("FIN 46"), which was issued in January 2003, defines the criteria necessary to be considered an operating company for which the consolidation accounting guidance of SFAS 94, *Consolidation of All Majority-Owned Subsidiaries ("SFAS 94"),* should be applied. SFAS 94 is a control-based model and requires consolidation for those entities in which the Company has a controlling financial interest. The usual condition for a controlling financial interest is ownership of a majority of the voting interest in an entity. FIN 46 prohibits an entity from being considered an operating company and applying the provisions of SFAS 94 if such entity does not have the characteristics of a controlling financial interest or does not have sufficient legal equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Accordingly, the Company consolidates operating companies in which it has a controlling financial interest. Operating companies in which the Company holds a non-controlling interest are accounted for under the equity method when the Company is able to exercise significant influence over the business activities of such entities. Significant influence is generally deemed to exist when the Company owns 20% to 50% of the voting equity of a corporation or when the Company holds at least 3% of a limited partnership interest. The cost method is applied when the ability to exercise significant influence is not present.

***Special Purpose Entities*** Special purpose entities ("SPEs") are corporations, trusts or partnerships that are established for a limited purpose. SPEs by their nature generally do not provide equity owners with significant voting powers because the SPE documents govern all material decisions. The Company' s primary involvement with SPEs relates to securitization transactions in which transferred assets, including mortgages, loans, receivables and other assets, are sold to an SPE and repackaged into securities (i.e., securitized). SPEs also may be used by the Company to create securities with a unique risk profile desired by investors and as a means of intermediating financial risk. In the normal course of business, the Company establishes SPEs, sells assets to SPEs, underwrites, distributes, and makes a market in securities issued by SPEs, transacts derivatives with SPEs, owns securities or residual interests in SPEs, and provides liquidity or other guarantees for SPEs.

The Company accounts for the transfers of financial assets, including transfers to SPEs, in accordance with SFAS 140. In accordance with this guidance, the Company recognizes transfers of financial assets as sales provided control has been relinquished. Control is deemed to be relinquished only when all of the following conditions have been met: (i) the assets have been isolated from the transferor, even in bankruptcy or other receivership (true sale opinions are required); (ii) the transferee has the right to pledge or exchange the assets received and (iii) the transferor has not maintained effective control over the transferred assets (e.g., a unilateral ability to repurchase a unique or specific

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

asset). Therefore, in accordance with this guidance, the Company derecognizes financial assets transferred in securitizations provided the Company has relinquished control over such assets.



There are two types of SPE' s including qualifying special purpose entities ("QSPEs") or variable interest entities ("VIEs"). The majority of the Company' s involvement with SPEs relates to securitization transactions meeting the SFAS 140 definition of a QSPE. A QSPE can generally be described as an entity with significantly limited powers that are intended to limit it to passively holding financial assets and distributing cash flows based on pre-set terms. Under SFAS 140 the Company is not required to, and does not, consolidate QSPEs. Rather, the Company accounts for its involvement with QSPEs under a financial components approach in which the Company recognizes only its retained involvement with the QSPE. The Company accounts for such retained interests at fair value with changes in fair value reported in earnings. FIN 46 does not alter the accounting for involvement with QSPEs.

The Company is a market leader in mortgage (both residential and commercial), municipal and other asset-backed securitizations that are principally transacted through QSPEs. The Company securitized approximately $173 billion of financial assets during 2003, including $138 billion of residential mortgages, $10 billion of commercial mortgages and $25 billion of other asset-backed financial instruments. At November 30, 2003, the Company had approximately $1.0 billion of non-investment grade retained interests from its securitization activities. Retained interests are recorded in Securities and other inventory positions owned on the Consolidated Statement of Financial Condition and primarily represent junior interests in commercial and residential securitization transactions. The Company records its trading assets, including retained interests, at fair value with related gains or losses recognized in Principal transactions in the Consolidated Statement of Income. For additional information see Note 4 to the Consolidated Financial Statements.

Certain SPEs do not meet the QSPE criteria due to their permitted activities not being sufficiently limited, or because the assets are not deemed qualifying financial instruments (e.g., real estate). Under FIN 46, the Company is required to consolidate a VIE if it is deemed to be the primary beneficiary of such entity. A VIE is an entity which lacks sufficient legal equity to absorb the entity' s expected losses (presumed to require minimum 10% equity), or for which the equity holders do not have substantive voting rights or do not participate substantively in the gains and losses of such entities. The primary beneficiary is the party that has either a majority of the expected losses or a majority of the expected residual returns of such entity, as defined. FIN 46 is effective for the Company' s involvement with VIEs created after January 31, 2003. With respect to the Company' s involvement with SPEs established prior to February 1, 2003, the Company follows the accounting guidance provided by EITF Topic D-14, *Transactions involving Special-Purpose Entities*, to determine whether consolidation is required. Under this guidance, the Company is not required to, and does not consolidate such SPE if a third party investor made a substantive equity investment in the SPE (minimum of 3%), was subject to first dollar risk of loss of such SPE, and had a controlling financial interest. Examples of the Company' s involvement with such VIEs include: collateralized debt obligations ("CDOs"), synthetic credit transactions, and other structured financing transactions.

With respect to CDO transactions in which a diversified portfolio of securities and/or loans is owned by a SPE and managed by an independent asset manager, the Company' s role is principally limited to acting as structuring and placement agent, warehouse provider, underwriter and market maker in the related CDO securities. In a typical CDO, at the direction of a third-party asset manager, the Company will warehouse securities or loans on its balance sheet, pending the transfer to the SPE once the permanent financing is completed in the capital markets. During 2003, the Company acted as warehouse provider and underwriter for approximately $601 million of CDO transactions. At November 30, 2003, the Company did not have any significant continuing involvement in the CDOs arranged by the Company other than acting as market maker (i.e., holding minority amounts of investment grade securities purchased in the secondary markets for short time periods) and, as such, the Company is not required to consolidate these transactions. At November 30, 2003 the Company' s holdings of subordinated classes in such CDO transactions was not material.

The Company is a dealer in credit default swaps and, as such, makes a market in buying and selling credit protection on single issuers as well as on portfolios of credit exposures. One of the mechanisms used by the Company to mitigate credit risk is synthetic credit transactions entered into with SPEs. In these transactions, the Company purchases credit protection in the form of a credit default swap from the SPE on referenced obligations (single issuer or portfolio). The Company pays a premium to the SPE for this protection and is secured by high quality collateral purchased by the SPE. Third-party investors in these SPEs are subject to default risk associated with the referenced obligations

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

under the default swap as well as credit risk to the assets held by the SPE. The Company' s maximum loss associated with its involvement with such synthetic credit transactions is the fair value of the Company' s credit default swaps with such SPEs, which approximated $229 million at November 30, 2003. While this amount represents the maximum amount the Company could potentially lose on such agreements the maximum loss is highly unlikely because the value of the underlying collateral held by the SPEs was $6.6 billion and was investment grade quality. Because the results of the Company' s expected loss calculations demonstrate that the investors in the SPEs bear a majority of the entity' s expected losses (because the investors assume default risk associated with both the reference portfolio



and the SPEs' assets), the Company is not deemed to be the primary beneficiary of these transactions and as such does not consolidate such SPEs under FIN 46.

The Company also enters into certain structured financing transactions with SPEs to facilitate customers' investment and/or funding needs. The Company' s involvement in these transactions is generally limited to providing liquidity or other limited downside protection to investors. In this regard, the Company provided liquidity protection to SPEs of approximately $0.7 billion and $3.3 billion as of November 30, 2003 and 2002, respectively. The Company' s maximum loss associated with such commitments is $0.7 billion at November 30, 2003, however the Company believes its actual risk to be significantly less as these liquidity commitments are generally over-collateralized with investment grade collateral. The Company anticipates consolidating such entities in the first quarter of 2004 upon adoption of FIN 46. In addition, the Company also provides certain limited downside protection to investors in SPEs. The Company' s maximum loss under such commitments was approximately $1.8 billion and $1.6 billion at November 30, 2003 and 2002, respectively. As the investor in such SPE bears all upside potential and significant downside variability, the Company is not deemed to be the primary beneficiary of these entities and as such does not expect to consolidate upon adoption of FIN 46 in the first quarter of 2004. The Company believes its actual exposure to be significantly less than the maximum exposure disclosed above, as the Company' s obligations are collateralized by the SPEs' assets and contain significant constraints under which such downside protection will be available.

In December 2003, the FASB issued a revised interpretation of FIN 46 that clarifies certain of the original interpretation' s provisions. While the Company has not yet completed its analysis of FIN 46 as revised, the Company does not anticipate that the adoption of the interpretation will have a material impact on the Company' s financial condition or its results of operations.

## RISK MANAGEMENT

As a leading global investment banking company, risk is an inherent part of the Company' s businesses. Global markets, by their nature, are prone to uncertainty and subject participants to a variety of risks. The Company has developed policies and procedures to identify, measure and monitor each of the risks involved in its trading, brokerage and investment banking activities on a global basis. The principal risks to the Company are market, credit, liquidity, legal and operational risks. Risk management is considered to be of paramount importance in the Company' s day-to-day operations. Consequently, the Company devotes significant resources (including investments in personnel and technology) across all of its worldwide trading operations to the measurement, analysis and management of risk.

The Company seeks to reduce risk through the diversification of its businesses, counterparties and activities in geographic regions. The Company accomplishes this objective by allocating the usage of capital to each of its businesses, establishing trading limits and setting credit limits for individual counterparties, including regional concentrations. The Company seeks to achieve adequate returns from each of its businesses commensurate with the risks they assume. Nonetheless, the effectiveness of the Company' s policies and procedures for managing risk exposure can never be completely or accurately predicted or fully assured. For example, unexpectedly large or rapid movements or disruptions in one or more markets or other unforeseen developments can have an adverse effect on the Company' s results of operations and financial condition. The consequences of these developments can include losses due to adverse changes in inventory values, decreases in the liquidity of trading positions, higher volatility in the Company' s earnings, increases in the Company' s credit exposure to customers and counterparties and increases in general systemic risk.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Overall risk management policy is established at the Office of the Chairman level and begins with the Capital Markets Committee, which consists of the Chief Executive Officer, other members of the Company' s Executive Committee, the Global Head of Risk, the Chief Economist and Strategist as well as various other business heads. The Capital Markets Committee serves to frame the Company' s risk opinion in the context of the global market environment. The Company' s Risk Committee, which consists of the Chief Executive Officer, other members of the Executive Committee and the Global Head of Risk, meets weekly and reviews all risk exposures, position concentrations and risk taking activities.

The Global Risk Management Group (the "Group") is independent of the trading areas and reports directly to the Office of the Chairman. The Group includes credit risk management, market risk management and operational risk management. Combining these disciplines facilitates the analysis of risk exposures, while leveraging personnel and information technology resources in a cost-efficient manner. The Group maintains staff in each of the Company' s regional trading centers and has daily contact with trading staff and senior management at all levels within the Company. These discussions include a review of trading positions and risk exposures.

**Credit Risk**

Credit risk represents the possibility a counterparty will be unable to honor its contractual obligations to the Company. Credit risk management is therefore an integral component of the Company' s overall risk management framework. The Credit Risk Management Department ("CRM Department") has global responsibility for implementing the Company' s overall credit risk management framework.

The CRM Department manages the credit exposure related to trading activities by giving initial credit approval for counterparties,



establishing credit limits by counterparty, country and industry group, and by requiring collateral in appropriate circumstances. In addition, the CRM Department strives to ensure that master netting agreements are obtained whenever possible. The CRM Department also considers the duration of transactions in making its credit decisions, along with the potential credit exposure for complex derivative transactions. The CRM Department is responsible for the continuous monitoring and review of counterparty credit exposure and creditworthiness and recommending valuation adjustments, when appropriate. Credit limits are reviewed periodically to ensure they remain appropriate in light of market events or the counterparty' s financial condition. For additional information see Note 3 to the Consolidated Financial Statements.

**Market Risk**

Market risk represents the potential change in value of a portfolio of financial instruments due to changes in market rates, prices and volatilities. Market risk management also is an essential component of the Company' s overall risk management framework. The Market Risk Management Department ("MRM Department") has global responsibility for implementing the Company' s overall market risk management framework. It is responsible for the preparation and dissemination of risk reports, developing and implementing the firm-wide Risk Management Guidelines, and evaluating adherence to these guidelines. These guidelines provide a clear framework for risk management decision making. To that end, the MRM Department identifies and quantifies risk exposures, develops limits and reports and monitors these risks with respect to the approved limits. The identification of material market risks inherent in positions includes, but is not limited to, interest rate, equity and foreign exchange risk exposures. In addition to these risks, the MRM Department also evaluates liquidity risks, credit and sovereign concentrations.

The MRM Department uses qualitative as well as quantitative information in managing trading risk, believing a combination of the two approaches results in a more robust and complete approach to the management of trading risk. Quantitative information is developed from a variety of risk methodologies based on established statistical principles. To ensure high standards of analysis, the MRM Department has retained seasoned risk managers with the requisite experience and academic and professional credentials.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Market risk is present in cash products, derivatives and contingent claim structures that exhibit linear as well as non-linear profit and loss sensitivity. The Company' s exposure to market risk varies in accordance with the volume of client-driven market-making transactions, the size of the Company' s proprietary positions, and the volatility of financial instruments traded. The Company seeks to mitigate, whenever possible, excess market risk exposures through the use of futures and option contracts and offsetting cash market instruments.

The Company participates globally in interest rate, equity and foreign exchange markets. The Company' s Fixed Income division has a broadly diversified market presence in U.S. and foreign government bond trading, emerging market securities, corporate debt (investment and non-investment grade), money market instruments, mortgages and mortgage- and asset-backed securities, real estate, municipal bonds and interest rate derivatives. The Company' s Equities division facilitates domestic and foreign trading in equity instruments, indices and related derivatives. The Company' s foreign exchange businesses are involved in trading currencies on a spot and forward basis as well as through derivative products and contracts.

The Company incurs short-term interest rate risk in the course of facilitating the orderly flow of customer transactions through the maintenance of government and high grade corporate bond inventories. Market making in high yield instruments exposes the Company to additional risk due to potential variations in credit spreads. Trading in international markets exposes the Company to spread risk between the term structure of interest rates in different countries. Mortgages and mortgage-related securities are subject to prepayment risk and changes in the level of interest rates. Trading in derivatives and structured products exposes the Company to changes in the level and volatility of interest rates. The Company actively manages interest rate risk through the use of interest rate futures, options, swaps, forwards and offsetting cash-market instruments. Inventory holdings, concentrations and agings are monitored closely and used by management to selectively hedge or liquidate undesirable exposures.

The Company is a significant intermediary in the global equity markets through its market making in U.S. and non-U.S. equity securities, including common stock, convertible debt, exchange-traded and OTC equity options, equity swaps and warrants. These activities expose the Company to market risk as a result of price and volatility changes in its equity inventory. Inventory holdings are also subject to market risk resulting from concentrations and changes in liquidity conditions that may adversely impact market valuation. Equity market risk is actively managed through the use of index futures, exchange-traded and OTC options, swaps and cash instruments.

The Company enters into foreign exchange transactions to facilitate the purchase and sale of non-dollar instruments, including equity and interest rate securities. The Company is exposed to foreign exchange risk on its holdings of non-dollar assets and liabilities. The Company is active in many foreign exchange markets and has exposure to the Euro, Japanese yen, British pound, Swiss franc and Canadian dollar, as well as a variety of developed and emerging market currencies. The Company hedges its risk exposures primarily through the use of currency forwards, swaps, futures and options.

If any of the strategies used to hedge or otherwise mitigate exposures to the various types of risks described above are not effective, the Company could incur losses. See Notes 1 and 3 to the Consolidated Financial Statements for further information regarding the Company' s use of derivative financial instruments to hedge interest rate, currency, security and commodity price and other market risks.



**Operational Risk**

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational Risk Management is responsible for implementing and maintaining the Company' s overall global operational risk management framework, which seeks to minimize these risks through assessing, reporting, monitoring and tracking operational risks.

The Company recognizes that maintaining its reputation among clients, investors, regulators and the general public is one important aspect of minimizing legal and operational risks. Maintaining the Company' s reputation depends on a large number of factors, including the selection of the Company' s clients and the conduct of its business activities. The Company seeks to maintain its reputation by screening potential investment banking clients and by conducting its business activities in accordance with high ethical standards.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Potential investment banking clients are screened through a multi-step process that begins with the individual business units and product groups. In screening clients, these groups undertake a comprehensive review of the client and its background and the potential transaction to determine, among other things, whether they pose any risks to the Company' s reputation. Following this initial review, potential clients and transactions are screened by the Lehman Brothers Investment Banking Commitment Committee, which is composed of senior members from various corporate and operating divisions of the Company. The Commitment Committee reviews the nature of the client and its business, the due diligence conducted by the business units and product groups, and the proposed terms of the transaction, in order to determine overall acceptability of the proposed transaction. In doing so, the Commitment Committee evaluates the appropriateness of the transaction for the Company, including a consideration of ethical and social responsibility issues and the potential effect of the transaction on the Company' s reputation.

**Value-At-Risk**

For purposes of Securities and Exchange Commission ("SEC") risk disclosure requirements, the Company discloses an entity-wide value-at-risk for virtually all of its trading activities. In general, the Company' s value-at-risk measures potential loss of trading revenues at a given confidence level over a specified time horizon. Value-at-risk over a one-day holding period measured at a 95% confidence level implies the potential loss of daily trading revenue will be at least as large as the value-at-risk amount on one out of every 20 trading days.

The Company' s methodology estimates a reporting day value-at-risk using actual daily trading revenues over the previous 250 trading days. This estimate is measured as the loss, relative to the median daily trading revenue. The Company also estimates an average of daily value-at-risk measures over the reporting period.

Value-at-risk is one measurement of potential loss in trading revenues that may result from adverse market movements over a specified period of time with a selected likelihood of occurrence. As with all measures of value-at-risk, the Company' s estimate has substantial limitations due to its reliance on historical performance, which is not necessarily a predictor of the future. Consequently, this value-at-risk estimate is only one of a number of tools the Company uses in its daily risk management activities. The following table sets forth the daily value-at-risk for each component of market risk as well as total value-at-risk.

**VALUE-AT-RISK**

| IN MILLIONS | November 30, 2003 | November 30, 2002 | Year Ended November 30, 2003 | | |
|---|---|---|---|---|---|
| | | | Average | High | Low |
| Interest rate risk | $ **18.2** | $ 15.8 | $ **17.6** | $ **19.9** | $ **15.5** |
| Equity price risk | **7.0** | 8.0 | **7.2** | **8.7** | **6.4** |
| Foreign exchange risk | **3.7** | 2.2 | **2.9** | **3.7** | **2.2** |
| Diversification benefit | **(7.2)** | (5.2) | **(5.8)** | | |
| Total | $ **21.7** | $ 20.8 | $ **21.9** | $ **25.4** | $ **20.5** |

The average, high and low values-at-risk for the year ended November 30, 2002 were $21.0 million, $23.4 million and $17.5 million, respectively. The increase in interest rate and foreign exchange risk at November 30, 2003 from November 30, 2002 reflects higher volatility in fixed income securities and foreign exchange markets, while the decrease in equity risk is primarily related to lower equity positions held for customer flow purposes.

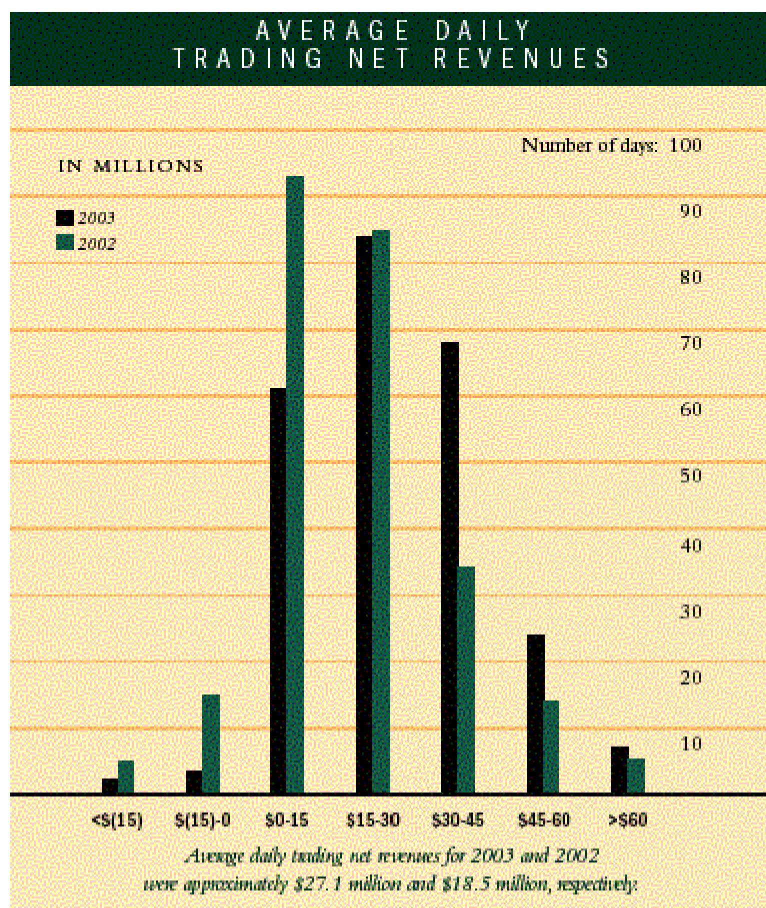
**Distribution of Daily Net Revenues**

Substantially all of the Company' s inventory positions are marked-to-market daily with changes recorded in net revenues. The following chart sets forth the frequency distribution for daily net revenues for the Company' s Capital Markets and Client Services segments (excluding asset management fees) for the years ended November 30, 2003 and 2002.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

As discussed throughout Management' s Discussion and Analysis, the Company seeks to reduce risk through the diversification of its businesses and a focus on customer flow activities. This diversification and focus, combined with the Company' s risk management controls and processes, helps mitigate the net revenue volatility inherent in the Company' s trading activities. Although historical performance is not necessarily indicative of future performance, the Company believes its focus on business diversification and customer flow activities should continue to reduce the volatility of future net trading revenues.






*Average daily trading net revenues for 2003 and 2002 were approximately $27.1 million and $18.5 million, respectively.*

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The following is a summary of the Company' s critical accounting policies and estimates. For a full description of these and other accounting policies, see Note 1 to the Consolidated Financial Statements.

### Use of Estimates

The Company' s financial statements are prepared in conformity with generally accepted accounting principles, many of which require the use of estimates and assumptions. Management believes the estimates used in preparing its financial statements are reasonable and prudent. Actual results could differ from these estimates particularly in light of the industry in which the Company operates.

### Fair Value

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The determination of fair value is a critical accounting policy that is fundamental to the Company' s financial condition and results of operations. The Company records its inventory positions including Securities and other inventory positions owned and Securities and other inventory positions sold but not yet purchased at market or fair value, with unrealized gains and losses reflected in Principal transactions in the Consolidated Statement of Income. In all instances, the Company believes it has established rigorous internal control processes to ensure the Company uses reasonable and prudent measurements of fair value on a consistent basis.

When evaluating the extent to which management estimates may be required in preparing the Company' s financial statements, the Company believes it is useful to analyze the balance sheet as shown in the following table:

**SUMMARY BALANCE SHEET**

**IN MILLIONS**
**NOVEMBER 30, 2003**

| | | | |
|---|---|---|---|
| **ASSETS** | | | |
| Securities and other inventory positions owned | $ | 137,040 | 44% |
| Secured financings | | 138,812 | 45% |
| Receivables and other assets | | 32,648 | 10% |
| Identifiable intangible assets and goodwill | | 3,561 | 1% |
| Total assets | $ | 312,061 | 100% |
| | | | |
| **LIABILITIES AND EQUITY** | | | |
| Securities and other inventory positions sold but not yet purchased | $ | 75,882 | 24% |
| Secured financings | | 135,836 | 43% |
| Payables and other accrued liabilities | | 42,330 | 14% |
| Total capital | | 58,013 | 19% |
| Total liabilities and equity | $ | 312,061 | 100% |

A significant majority of the Company' s assets and liabilities are recorded at amounts for which significant management estimates are not used. The following balance sheet categories, comprising 55% of total assets and 76% of liabilities and equity are valued at either historical cost or at contract value (including accrued interest) which, by their nature, do not require the use of significant estimates: Secured financings, Receivables and other assets, and Payables and other accrued liabilities and Total capital. Securities and other inventory positions owned and Securities, and other inventory positions sold but not yet purchased (long and short inventory positions, respectively), are recorded at market or fair value, the components of which may require, to varying degrees, the use of estimates in determining fair value. Also, determining the initial estimated fair values of acquired identifiable intangible assets and goodwill requires significant judgments and involves the use of significant estimates and assumptions.

When evaluating the extent to which management estimates may be used in determining the fair value for long and short inventory, the Company believes it is useful to consider separately derivatives and cash instruments.



**Derivatives**

The fair values of derivative assets and liabilities at November 30, 2003 were $15,766 million and $11,440 million, respectively. Included within these amounts were exchange-traded derivatives assets and liabilities of $2,199 million and $1,621 million for which fair value is determined based on quoted market prices. The fair values of the Company' s OTC derivative assets and liabilities at November 30, 2003 were $13.6 billion and $9.8 billion, respectively. OTC derivative assets represent the Company' s unrealized gains, net of unrealized losses, for situations in which the Company has a master netting agreement. Similarly, liabilities represent net amounts owed to counterparties.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

## OTC DERIVATIVES

| IN MILLIONS NOVEMBER 30, 2003 | Fair Value of OTC Derivative Contracts by Maturity | | | | |
|---|---|---|---|---|---|
| | Less than 1 year | 2-5 years | 5-10 years | Greater than 10 years | Total |
| **ASSETS** | | | | | |
| Interest rate, currency and credit default swaps and options | $ 491 | $ 2,376 | $ 2,638 | $ 2,097 | $ 7,602 |
| Foreign exchange forward contracts and options | 1,586 | 165 | 52 | 4 | 1,807 |
| Other fixed income securities contracts | 1,264 | – | – | – | 1,264 |
| Equity contracts (including swaps, warrants and options) | 1,806 | 919 | 167 | 2 | 2,894 |
| Total | $ 5,147 | $ 3,460 | $ 2,857 | $ 2,103 | $ 13,567 |
| | 38% | 26% | 21% | 15% | 100% |
| **LIABILITIES** | | | | | |
| Interest rate, currency and credit default swaps and options | $ 2,006 | $ 384 | $ 2,650 | $ 574 | $ 5,614 |
| Foreign exchange forward contracts and options | 1,855 | 113 | 13 | 1 | 1,982 |
| Other fixed income securities contracts | 750 | – | – | – | 750 |
| Equity contracts (including swaps, warrants and options) | 648 | 780 | 32 | 13 | 1,473 |
| Total | $ 5,259 | $ 1,277 | $ 2,695 | $ 588 | $ 9,819 |
| | 54% | 13% | 27% | 6% | 100% |

The majority of the Company' s OTC derivatives are transacted in liquid trading markets for which fair value is determined using pricing models with readily observable market inputs. Examples of such derivatives include interest rate swap contracts, TBAs (classified in the above table as Other fixed income securities contracts), foreign exchange forward and option contracts in G-7 currencies and equity swap and option contracts on listed securities. However, the determination of fair value for certain less liquid derivatives requires the use of significant estimates. Such derivatives include certain credit derivatives, equity option contracts greater than five years, and certain other complex derivatives used by the Company in providing clients with hedging alternatives to unique exposures. The Company strives to limit the use of significant judgment by using consistent pricing assumptions between reporting periods and using observed market data for model inputs whenever possible. As the market for complex products develops, the Company refines its pricing models based on market experience to use the most current indicators of fair value.

### Cash Instruments

The majority of the Company' s non-derivative long and short inventory (i.e., cash instruments) is recorded at market value based on listed market prices or using third-party broker quotes, and therefore does not incorporate significant estimates. Examples of inventory valued in this manner include government securities, agency mortgage-backed securities, listed equities, money markets, municipal securities, corporate bonds and listed futures. However, in certain instances the Company may deem such quotations to be unrealizable (e.g., when the instruments are thinly traded or when the Company holds a substantial block of a particular security such that the listed price is not deemed to be readily realizable). In such instances, the Company



determines fair value based on management' s best estimate giving appropriate consideration to reported prices and the extent of public trading in similar securities, the discount from the listed price associated with the cost at date of acquisition and the size of the position held in relation

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

to the liquidity in the market, among other factors. When the size of the Company' s holding of a listed security is likely to impair the Company' s ability to realize the quoted market price, the Company records the position at a discount to the quoted price reflecting the Company' s best estimate of fair value.

When quoted prices are not available, fair value is determined based on pricing models or other valuation techniques, including the use of implied pricing from similar instruments. Pricing models are typically used to derive fair value based on the net present value of estimated future cash flows including adjustments, when appropriate, for liquidity, credit and/or other factors. For the vast majority of instruments valued through pricing models, significant estimates are not required because the market inputs to such models are readily observable and liquid trading markets provide clear evidence to support the valuations derived from such pricing models. Examples of inventory valued using pricing models or other valuation techniques for which the use of management estimates are deemed necessary include private equity investments, certain high yield positions, certain mortgages, mortgage-backed and real estate inventory and non-investment grade retained interests.

**Private Equity and Other Principal Investments**

The Company' s Private Equity business operates in five major asset classes: Merchant Banking, Real Estate, Venture Capital, Fixed Income-related and Third Party Funds. The Company has raised privately placed funds in all of these classes, for which the Company acts as general partner and in which it has general and in some cases limited partner interests. In addition, the Company generally co-invests directly in the investments made by the funds and may make other non-fund-related direct investments. The Company carries its private equity investments, including its general and limited partnership interests, at fair value. At November 30, 2003 and 2002, the Company' s private equity related investments were $1,303 million and $965 million, respectively. At November 30, 2003 the largest industry concentration was 26% and the largest single-investment exposure was $106 million. In addition, the Company held approximately $80 million in an energy-related principal investment at November 30, 2003.

The determination of fair value for these investments often requires the use of estimates and assumptions because these investments are generally less liquid and often contain trading restrictions. The Company estimates that approximately $113 million of these investments have readily determinable fair values because they are publicly-traded securities with no remaining trading restrictions. For the remainder of these positions, fair value is based on the Company' s assessment of the underlying investments incorporating valuations that consider expected cash flows, earnings multiples and/or comparisons to similar market transactions. Valuation adjustments, which may involve the use of significant management estimates, are an integral part of pricing these instruments, reflecting consideration of credit quality, concentration risk, sale restrictions and other liquidity factors. Additional information about the Company' s private equity and other principal investment activities, including related commitments, can be found in Note 11 to the Consolidated Financial Statements.

**High Yield**

The Company underwrites, invests and makes markets in high yield corporate debt securities. The Company also syndicates, trades and invests in loans to below investment grade-rated companies. For purposes of this discussion, high yield debt instruments are defined as securities of or loans to companies rated BB+ or lower, or equivalent ratings by recognized credit rating agencies, as well as non-rated securities or loans that, in the opinion of management, are non-investment grade. Non-investment grade securities generally involve greater risks than investment grade securities due to the issuer' s creditworthiness and the lower liquidity of the market for such securities. In addition, these issuers generally have relatively higher levels of indebtedness resulting in an increased sensitivity to adverse economic conditions. The Company recognizes these risks and seeks to reduce market and credit risk through the diversification of its products and counterparties. High yield debt instruments are carried at fair value, with unrealized gains or losses recognized in the Consolidated Statement of Income. Such instruments at November 30, 2003 and November 30, 2002 included long positions with an aggregate market value of approximately $4.0 billion and short positions with an aggregate market value of approximately $0.3 billion and $1.1 billion, respectively. At November 30, 2003, the largest industry concentration was 10%. The majority of these positions are valued using broker quotes or listed market prices. However, at November 30, 2003, approximately $800 million of these positions were valued utilizing other valuation techniques because there was little or no trading activity. In such instances, the Company uses prudent judgment in determining fair value, which may involve using analyses of

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

credit spreads associated with pricing of similar instruments, or other valuation techniques. The Company mitigates its aggregate and single-issuer net exposure through the use of derivatives, non-recourse securitization financing and other financial instruments.

**Mortgages, Mortgage-backed and Real Estate Inventory**

The Company is a market leader in mortgage-backed securities trading and loan securitizations (both residential and commercial). The Company' s mortgage related inventory includes loans held prior to securitization, securities and real estate owned. In this activity, the Company generally purchases mortgage loans from loan



originators or in the secondary market and aggregates pools of loans for securitization. The Company also originates mortgage loans. From time-to-time, the Company may utilize non-recourse financings to fund these positions. The Company records mortgage loans and direct real estate investments at fair value, with related mark-to-market gains and losses recognized in Principal transactions revenue. Management estimates are generally required in determining the fair value of certain residential and commercial mortgage loans and direct real estate, as they are based upon analyses of both cash flow projections and underlying property values. The Company uses independent appraisals to support management' s assessment of the property in determining fair value for these positions. Approximately $13 billion of the Company' s total $39 billion of mortgage, mortgage-backed and real estate inventory utilize the above valuation methodologies. This includes commercial real estate and commercial mortgage loan risk of $6.1 billion.

**Non-Investment Grade Retained Interests**

In addition, the Company held approximately $1.0 billion of non-investment grade retained interests at November 30, 2003, down from $1.1 billion at November 30, 2002. Because these interests primarily represent the junior interests in commercial and residential mortgage securitizations for which there are not active trading markets, estimates generally are required in determining fair value. The Company values these instruments using prudent estimates of expected cash flows, and considers the valuation of similar transactions in the market. (See Note 4 to the Consolidated Financial Statements for additional information on the impact of adverse changes in assumptions on the fair value of these interests.)

**Real Estate Charges**

As a result of the Company' s decision to exit its downtown New York area facilities after the events of September 11, 2001 and the Company' s decision in 2002 to reconfigure certain of its global real estate facilities, the Company recognized real estate charges in both 2003 and 2002. The recognition of these charges required significant management estimates including the Company' s estimation of the vacancy periods prior to subleasing, the anticipated rate of subleases, and the amount of incentives (e.g., free rent periods) that may be required to induce sub-lessees.

**Identifiable Intangible Assets and Goodwill**

The Company acquired Neuberger in October 2003 for a net purchase price of approximately $2.8 billion, excluding net cash and short-term investments acquired of approximately $276 million. The cost was allocated to the underlying net assets based on preliminary estimates of their estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired of $2,254 million was recorded as goodwill. The judgments made in determining the estimated fair values and expected useful lives assigned to each class of assets and liabilities acquired can significantly affect net income. Determining the fair values and useful lives of certain assets acquired and liabilities assumed−intangible assets in particular−requires significant judgment and involves the use of significant estimates and assumptions. The

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Company is obtaining third-party valuations of certain intangible assets preliminarily carried at $951 million in the Consolidated Statement of Financial Condition at November 30, 2003 and the allocation of the purchase price therefore is subject to refinement.

The Company is required to assess for impairment of goodwill and other intangible assets with indefinite lives at least annually using fair value measurement techniques. If the estimated fair value of a reporting unit (an operating segment or one organizational level below an operating segment) exceeds its carrying value, goodwill of the reporting unit is considered not to be impaired. If the carrying value of a reporting unit exceeds its estimated fair value, the implied fair value of the reporting unit' s goodwill is compared with the carrying amount of that goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. If the carrying amount of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized equal to that excess. The impairment test for other intangible assets with indefinite lives is performed by comparing the estimated fair value of the intangible asset, with its carrying value. If the carrying value of the intangible asset exceeds its estimated fair value an impairment loss is recognized equal to that excess. Periodically estimating the fair value of a reporting unit and intangible assets with indefinite lives involves significant judgment and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant effect on whether or not an impairment charge is recognized and the magnitude of such charge.



## NEW ACCOUNTING DEVELOPMENTS

During the first quarter of 2003, the Company adopted EITF Issue No. 02-03, *"Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved In Energy Trading and Risk Management Activities"* ("EITF 02-03"). EITF 02-03 clarified that profit should not be recognized at the inception of a derivative contract, if the contract does not have observable pricing. In such instances, the transaction price is deemed to be the best indicator of fair value and is required to be utilized. The effect upon adoption of EITF 02-03 was not material to the Company' s financial condition or results of operations.

In May 2003, the FASB issued SFAS No. 150, *"Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity."* The statement specifies how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. However, in November 2003 the FASB indefinitely deferred the effective date of the statement' s provisions for certain preferred securities subject to mandatory redemption. The remaining provisions of this statement are generally effective for financial instruments entered into after May 31, 2003. The Company was required to adopt the statement for all pre-existing transactions as of the Company' s fourth quarter of 2003. The effect of adopting SFAS No. 150 was not material to the Company' s financial condition or results of operations.

In January 2003, the FASB issued FIN 46. This interpretation provides new consolidation accounting guidance for entities involved with VIEs. Under FIN 46 the Company is required to consolidate a VIE when it is deemed to be the primary beneficiary of such entity. The primary beneficiary is the party which has either a majority of the expected losses or a majority of the expected residual returns of the entity. FIN 46 is effective for all VIEs created after January 31, 2003. In December 2003, the FASB in an effort to clarify the application of FIN 46 issued a revised interpretation and delayed the initial implementation date as it relates to entities established prior to January 31, 2003. The Company is required to adopt the revised interpretation as of February 28, 2004 as it relates to the Company' s involvement with SPEs established prior to January 31, 2003. In addition, the Company is required to adopt as of May 31, 2004 the revised interpretation to the extent it may apply to operating companies established prior to January 31, 2003.

The Company has adopted the provisions of FIN 46 for those entities established after January 31, 2003 and therefore the Company has consolidated such VIEs for which the Company was deemed to be the primary beneficiary. The impact of applying FIN 46 to such transactions in 2003 was not material to the Company' s results of operations or statement of financial condition. While the Company is continuing its analysis of the revised interpretation, the Company does not anticipate that the adoption of the revised interpretation in 2004 will have a material impact on the Company' s financial condition or its results of operations.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

However, the Company does expect that the adoption of FIN 46 as revised will result in the de-consolidation of its trusts that issue preferred securities subject to mandatory redemption effective as of February 28, 2004. The de-consolidation will have the effect of reclassifying such preferred securities subject to mandatory redemption out of the mezzanine classification of the Company' s Consolidated Statement of Financial Condition and into Long-Term Debt. Likewise the Company will reclassify, on a prospective basis, the pretax amount of dividends on trust preferred securities to Interest expense in the Company' s results of operations.

## EFFECTS OF INFLATION

Because the Company' s assets are, to a large extent, liquid in nature, they are not significantly affected by inflation. However, the rate of inflation affects the Company' s expenses such as employee compensation, office space leasing costs and communications charges, which may not be readily recoverable in the prices of services offered by the Company. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect the Company' s financial position and results of operations in certain businesses.



## REPORT OF INDEPENDENT AUDITORS

**The Board of Directors and Stockholders of Lehman Brothers Holdings Inc.**

We have audited the accompanying consolidated statement of financial condition of Lehman Brothers Holdings Inc. and Subsidiaries (the "Company") as of November 30, 2003 and 2002, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended November 30, 2003. These financial statements are the responsibility of the Company' s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lehman Brothers Holdings Inc. and Subsidiaries at November 30, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended November 30, 2003, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

New York, New York
January 29, 2004



## CONSOLIDATED STATEMENT OF INCOME

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| IN MILLIONS, EXCEPT PER SHARE DATA<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **REVENUES** | | | |
| Principal transactions | **$ 4,280** | $ 1,951 | $ 2,779 |
| Investment banking | **1,747** | 1,771 | 2,000 |
| Commissions | **1,210** | 1,286 | 1,091 |
| Interest and dividends | **9,942** | 11,728 | 16,470 |
| Other | **108** | 45 | 52 |
| Total revenues | **17,287** | 16,781 | 22,392 |
| Interest expense | **8,640** | 10,626 | 15,656 |
| Net revenues | **8,647** | 6,155 | 6,736 |
| **NON-INTEREST EXPENSES** | | | |
| Compensation and benefits | **4,318** | 3,139 | 3,437 |
| Technology and communications | **598** | 552 | 501 |
| Brokerage and clearance fees | **367** | 329 | 308 |
| Occupancy | **319** | 287 | 198 |
| Professional fees | **158** | 129 | 152 |
| Business development | **149** | 146 | 183 |
| Other | **125** | 74 | 82 |
| Other real estate reconfiguration charge | **77** | 128 | – |
| September 11th related (recoveries)/expenses, net | – | (108) | 127 |
| Regulatory settlement | – | 80 | – |
| Total non-interest expenses | **6,111** | 4,756 | 4,988 |
| Income before taxes and dividends on trust preferred securities | **2,536** | 1,399 | 1,748 |
| Provision for income taxes | **765** | 368 | 437 |
| Dividends on trust preferred securities | **72** | 56 | 56 |
| Net income | **$ 1,699** | $ 975 | $ 1,255 |
| Net income applicable to common stock | **$ 1,649** | $ 906 | $ 1,161 |
| Earnings per common share | | | |
| Basic | **$ 6.71** | $ 3.69 | $ 4.77 |
| Diluted | **$ 6.35** | $ 3.47 | $ 4.38 |

See Notes to Consolidated Financial Statements.



## CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

| IN MILLIONS<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | **$ 7,922** | $ 3,699 |
| Cash and securities segregated and on deposit for regulatory and other purposes | **3,100** | 2,803 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | 2003 | 2002 |
|---|---|---|
| Securities and other inventory positions owned: | | |
| (includes $35,679 in 2003 and $22,211 in 2002 pledged as collateral) | **137,040** | 119,278 |
| Collateralized agreements: | | |
| Securities purchased under agreements to resell | **87,416** | 94,341 |
| Securities borrowed | **51,396** | 20,497 |
| Receivables: | | |
| Brokers, dealers and clearing organizations | **4,875** | 3,775 |
| Customers | **8,809** | 8,279 |
| Others | **1,626** | 1,910 |
| Property, equipment and leasehold improvements (net of accumulated depreciation and amortization of $921 in 2003 and $590 in 2002) | **2,806** | 2,075 |
| Other assets | **3,510** | 3,466 |
| Identifiable intangible assets and goodwill (net of accumulated amortization of $166 in 2003 and $155 in 2002) | **3,561** | 213 |
| Total assets | **$ 312,061** | $ 260,336 |

See Notes to Consolidated Financial Statements.



## CONSOLIDATED STATEMENT OF FINANCIAL CONDITION (Continued)

| IN MILLIONS, EXCEPT PER SHARE DATA<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Commercial paper and short-term debt | **$ 2,331** | $ 2,369 |
| Securities and other inventory positions sold but not yet purchased | **75,882** | 69,034 |
| Collateralized financing: | | |
| Securities sold under agreements to repurchase | **107,304** | 94,725 |
| Securities loaned | **13,988** | 8,137 |
| Other secured borrowings | **14,544** | 11,844 |
| Payables: | | |
| Brokers, dealers and clearing organizations | **3,067** | 1,787 |
| Customers | **27,666** | 17,477 |
| Accrued liabilities and other payables | **9,266** | 6,633 |
| Long-term debt: | | |
| Senior notes | **41,303** | 36,283 |
| Subordinated indebtedness | **2,226** | 2,395 |
| Total liabilities | **297,577** | 250,684 |
| Commitments and contingencies | | |
| Preferred securities subject to mandatory redemption | **1,310** | 710 |
| **STOCKHOLDERS' EQUITY** | | |
| Preferred stock | **1,045** | 700 |
| Common stock, $0.10 par value; Shares authorized: 600,000,000 in 2003 and 2002; Shares issued: 294,575,285 in 2003 and 258,791,416 in 2002; Shares outstanding: 266,679,056 in 2003 and 231,131,043 in 2002 | **29** | 25 |
| Additional paid-in capital | **6,164** | 3,628 |
| Accumulated other comprehensive income (net of tax) | **(16)** | (13) |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | |
|---|---|---|
| Retained earnings | **7,129** | 5,608 |
| Other stockholders' equity, net | **1,031** | 949 |
| Common stock in treasury, at cost: 27,896,229 shares in 2003 and 27,660,373 shares in 2002 | **(2,208)** | (1,955) |
| Total stockholders' equity | **13,174** | 8,942 |
| Total liabilities and stockholders' equity | **$ 312,061** | $ 260,336 |

See Notes to Consolidated Financial Statements.



**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **PREFERRED STOCK** | | | |
| 5.94% Cumulative, Series C: | | | |
| Beginning and ending balance | **$ 250** | $ 250 | $ 250 |
| 5.67% Cumulative, Series D: | | | |
| Beginning and ending balance | **200** | 200 | 200 |
| 7.115% Fixed/Adjustable Rate Cumulative, Series E: | | | |
| Beginning and ending balance | **250** | 250 | 250 |
| 6.50% Cumulative, Series F: | | | |
| Beginning balance | – | – | – |
| Shares issued | **345** | – | – |
| Ending balance | **345** | – | – |
| Redeemable Voting: | | | |
| Beginning and ending balance | – | – | – |
| Total Preferred Stock, ending balance | **1,045** | 700 | 700 |
| | | | |
| **COMMON STOCK, PAR VALUE $0.10 PER SHARE** | | | |
| Beginning balance | **25** | 25 | 25 |
| Shares issued in connection with Neuberger acquisition | **3** | – | – |
| Issued | **1** | – | – |
| Ending balance | **29** | 25 | 25 |
| | | | |
| **ADDITIONAL PAID-IN CAPITAL** | | | |
| Beginning balance | **3,628** | 3,562 | 3,589 |
| RSUs exchanged for Common Stock | **(36)** | 63 | (13) |
| Employee stock-based awards | **107** | 53 | 53 |
| Shares issued to RSU Trust | **(459)** | (401) | (628) |
| Tax benefits from the issuance of stock-based awards | **543** | 347 | 549 |
| Shares issued in connection with Neuberger acquisition | **2,371** | – | – |
| Other, net | **10** | 4 | 12 |
| Ending balance | **$ 6,164** | $ 3,628 | $ 3,562 |

See Notes to Consolidated Financial Statements.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)**

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **ACCUMULATED OTHER COMPREHENSIVE INCOME** | | | |
| Beginning balance | **$ (13)** | $ (10) | $ (8) |
| Translation adjustment, net (1) | **(3)** | (3) | (2) |
| Ending balance | **(16)** | (13) | (10) |
| **RETAINED EARNINGS** | | | |
| Beginning balance | **5,608** | 4,798 | 3,713 |
| Net income | **1,699** | 975 | 1,255 |
| Dividends declared: | | | |
| 5.00% Cumulative Convertible Voting Series A and B Preferred Stock | – | – | (1) |
| 5.94% Cumulative, Series C Preferred Stock | **(15)** | (15) | (15) |
| 5.67% Cumulative, Series D Preferred Stock | **(11)** | (11) | (11) |
| 7.115% Fixed/Adjustable Rate Cumulative, Series E Preferred Stock | **(18)** | (18) | (18) |
| 6.50% Cumulative, Series F Preferred Stock | **(6)** | – | – |
| Redeemable Voting Preferred Stock | – | (25) | (50) |
| Common Stock | **(128)** | (96) | (75) |
| Ending balance | **7,129** | 5,608 | 4,798 |
| **COMMON STOCK ISSUABLE** | | | |
| Beginning balance | **2,822** | 2,933 | 2,524 |
| RSUs exchanged for Common Stock | **(425)** | (463) | (215) |
| Deferred stock awards granted | **957** | 407 | 624 |
| Other, net | **(1)** | (55) | – |
| Ending balance | **3,353** | 2,822 | 2,933 |
| **COMMON STOCK HELD IN RSU TRUST** | | | |
| Beginning balance | **(754)** | (827) | (647) |
| Shares issued to RSU Trust | **(518)** | (297) | (403) |
| RSUs exchanged for Common Stock | **444** | 387 | 223 |
| Other, net | **(24)** | (17) | – |
| Ending balance | **(852)** | (754) | (827) |
| **DEFERRED STOCK COMPENSATION** | | | |
| Beginning balance | **(1,119)** | (1,360) | (1,280) |
| Deferred stock awards granted | **(999)** | (407) | (624) |
| Amortization of deferred compensation, net | **625** | 570 | 544 |
| Other, net | **23** | 78 | – |
| Ending balance | **(1,470)** | (1,119) | (1,360) |
| **COMMON STOCK IN TREASURY, AT COST** | | | |
| Beginning balance | **(1,955)** | (1,362) | (835) |
| Treasury stock purchased | **(1,508)** | (1,510) | (1,676) |
| RSUs exchanged for Common Stock | **18** | – | 5 |
| Shares issued for preferred stock conversion | – | – | 44 |
| Employee stock-based awards | **260** | 219 | 69 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | |
|---|---|---|---|
| Shares issued to RSU Trust | **977** | 698 | 1,031 |
| Ending balance | **(2,208)** | (1,955) | (1,362) |
| Total stockholders' equity | **$ 13,174** | $ 8,942 | $ 8,459 |

(1) Net of income taxes of $(1) in 2003, $(1) in 2002 and $(1) in 2001.

See Notes to Consolidated Financial Statements.



**CONSOLIDATED STATEMENT OF CASH FLOWS**

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Net income | **$ 1,699** | $ 975 | $ 1,255 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | **315** | 258 | 174 |
| Deferred tax provision (benefit) | **(166)** | (670) | (643) |
| Tax benefit from issuance of stock-based awards | **543** | 347 | 549 |
| Amortization of deferred stock compensation | **625** | 570 | 544 |
| September 11th (recoveries) expenses | **–** | (108) | 356 |
| Other real estate reconfiguration charge | **77** | 128 | – |
| Regulatory settlement | **–** | 80 | – |
| Other adjustments | **(26)** | 92 | (1) |
| Net change in: | | | |
| Cash and securities segregated and on deposit for regulatory and other purposes | **(297)** | 486 | (855) |
| Securities and other inventory positions owned | **(16,148)** | 1,708 | (13,219) |
| Securities borrowed, net of securities loaned | **(25,048)** | (6,907) | 4,923 |
| Other secured borrowings | **2,700** | 4,060 | 3,805 |
| Resale agreements, net of repurchase agreements | **19,504** | (18,442) | (8,957) |
| Receivables from brokers, dealers and clearing organizations | **(1,100)** | (320) | (1,793) |
| Receivables from customers | **(530)** | 3,844 | (4,538) |
| Securities and other inventory positions sold but not yet purchased | **6,848** | 17,704 | 16,045 |
| Payables to brokers, dealers and clearing organizations | **1,280** | (1,018) | 883 |
| Payables to customers | **10,189** | 3,646 | 2,194 |
| Accrued liabilities and other payables | **1,736** | 277 | (27) |
| Other operating assets and liabilities, net | **346** | (693) | (394) |
| Net cash provided by operating activities | **2,547** | 6,017 | 301 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from issuance of senior notes | **13,193** | 8,415 | 9,915 |
| Principal payments of senior notes | **(9,815)** | (9,014) | (7,646) |
| Proceeds from issuance of subordinated indebtedness | **190** | – | – |
| Principal payments of subordinated indebtedness | **(322)** | (715) | (204) |
| Issuances of common stock | **57** | 61 | 54 |
| Issuance of preferred securities subject to mandatory redemption | **600** | – | – |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Issuance of preferred stock, net of issuance costs | **345** | – | – |
| Net payments for commercial paper and short-term debt | **(38)** | (1,623) | (1,808) |
| Repurchases of preferred stock | – | – | (100) |
| Payments for treasury stock purchases | **(1,508)** | (1,510) | (1,676) |
| Issuance of treasury stock | **260** | 207 | 69 |
| Dividends paid | **(178)** | (165) | (163) |
| Net cash provided by (used in) financing activities | **2,784** | (4,344) | (1,559) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Purchases of property, equipment and leasehold improvements, net | **(451)** | (656) | (1,341) |
| Proceeds from the sale of 3 World Financial Center, net | – | 152 | – |
| Business acquisitions, net of cash acquired | **(657)** | (31) | – |
| Net cash used in investing activities | **(1,108)** | (535) | (1,341) |
| Net change in cash and cash equivalents | **4,223** | 1,138 | (2,599) |
| Cash and cash equivalents, beginning of period | **3,699** | 2,561 | 5,160 |
| Cash and cash equivalents, end of period | **$ 7,922** | $ 3,699 | $ 2,561 |

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION (in millions):
Interest paid totaled $8,654 in 2003, $10,686 in 2002 and $15,588 in 2001.
Income taxes paid totaled $717 in 2003, $436 in 2002 and $654 in 2001.

See Notes to Consolidated Financial Statements.




| | | |
|---|---|---|
| 73 | Note 1 | Summary of Significant Accounting Policies |
| 78 | Note 2 | Securities and Other Inventory Positions |
| 79 | Note 3 | Derivative Financial Instruments |
| 81 | Note 4 | Securitizations and Other Off-Balance Sheet Arrangements |
| 84 | Note 5 | Securities Pledged as Collateral |
| 84 | Note 6 | Business Combinations |
| 85 | Note 7 | Identifiable Intangible Assets and Goodwill |
| 86 | Note 8 | Short-Term Financings |
| 87 | Note 9 | Long-Term Debt |
| 89 | Note 10 | Fair Value of Financial Instruments |
| 89 | Note 11 | Commitments and Contingencies |
| 92 | Note 12 | Preferred Securities Subject to Mandatory Redemption |
| 93 | Note 13 | Preferred Stock |
| 94 | Note 14 | Common Stock |


Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

95 Note 15 Incentive Plans

98 Note 16 Earnings Per Common Share

98 Note 17 Capital Requirements

99 Note 18 Employee Benefit Plans

101 Note 19 Income Taxes

102 Note 20 Regulatory Settlement

102 Note 21 September 11th and Real Estate Reconfiguration Costs

104 Note 22 Segments

106 Note 23 Quarterly Information (unaudited)


## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis Of Presentation**

The consolidated financial statements include the accounts of Lehman Brothers Holdings Inc. ("Holdings") and subsidiaries (collectively, the "Company" or "Lehman Brothers"). Lehman Brothers is one of the leading global investment banks serving institutional, corporate, government and high-net-worth individual clients and customers. The Company' s worldwide headquarters in New York and regional headquarters in London and Tokyo are complemented by offices in additional locations in North America, Europe, the Middle East, Latin America and the Asia Pacific region. The Company is engaged primarily in providing financial services. The principal U.S. subsidiary of Holdings is Lehman Brothers Inc. ("LBI"), a registered broker-dealer. All material intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements are prepared in conformity with generally accepted accounting principles, which require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management estimates are required in determining the valuation of trading inventory, particularly Over-the-Counter ("OTC") derivatives, certain high yield positions, private equity and other principal investments and certain mortgage, mortgage-backed and real estate positions. Additionally, management estimates are required in assessing the realizability of deferred tax assets, the outcome of litigation, determining the allocation of goodwill and intangible assets acquired, and determining the components of the September 11th related (recoveries)/expenses, net and the real estate reconfiguration charges. Management believes the estimates used in preparing its financial statements are reasonable and prudent. Actual results could differ from these estimates.

Certain prior period amounts reflect reclassifications to conform to the current year' s presentation.



**Consolidation Accounting Policies**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

***Operating Companies*** Financial Accounting Standards Board ("FASB") Interpretation No. 46, *"Consolidation of Variable Interest Entities–an interpretation of ARB No. 51,"* ("FIN 46"), which was issued in January 2003, defines the criteria necessary to be considered an operating company for which the consolidation accounting guidance of Statement of Financial Accounting Standards ("SFAS") No. 94, *"Consolidation of All Majority-Owned Subsidiaries,"* ("SFAS 94") should be applied. SFAS 94 is a control-based model and requires consolidation for those entities in which the Company has a controlling financial interest. The usual condition for a controlling financial interest is ownership of a majority of the voting interest in an entity. FIN 46 defined operating companies to include only those entities that have sufficient legal equity to absorb the entities' expected losses (presumed to require minimum 10% equity), and for which the equity holders have substantive voting rights and participate substantively in the gains and losses of such entities. Accordingly, the Company consolidates operating companies in which it has a controlling financial interest. Operating companies in which the Company holds a non-controlling interest are accounted for under the equity method when the Company is able to exercise significant influence over the business activities of such entities. Significant influence is generally deemed to exist when the Company owns 20% to 50% of the voting equity of a corporation or when the Company holds at least 3% of a limited partnership interest. The cost method is applied when the ability to exercise significant influence is not present.

***Special Purpose Entities*** Special purpose entities ("SPEs") are corporations, trusts or partnerships that are established for a limited purpose. SPEs by their nature generally do not provide equity owners with significant voting powers because the SPE documents govern all material decisions. The Company' s primary involvement with SPEs relates to securitization transactions in which transferred assets, including mortgages, loans, receivables and other assets, are sold to an SPE and repackaged into securities (i.e., securitized). SPEs also may be used by the Company to create securities with a unique risk profile desired by investors and as a means of intermediating financial risk. In the normal course of business, the Company may establish SPEs, sell assets to SPEs, underwrite, distribute, and make a market in securities issued by SPEs, transact derivatives with SPEs, own securities or residual interests in SPEs, and provide liquidity or other guarantees for SPEs.

The Company accounts for the transfers of financial assets, including transfers to SPEs, in accordance with SFAS No. 140, *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,"* ("SFAS 140"). In accordance with this guidance, the Company recognizes transfers of financial assets as sales provided control has been relinquished. Control is deemed to be relinquished only when all of the following conditions have been met: (i) the assets have been isolated from the transferor, even in bankruptcy or other receivership (true sale opinions are required); (ii) the transferee has the right to pledge or exchange the assets received and (iii) the transferor has not maintained effective control over the transferred assets (e.g., a unilateral ability to repurchase a unique or specific asset). Therefore, in accordance with this guidance, the Company derecognizes financial assets transferred in securitizations provided the Company has relinquished control over such assets.

There are two types of SPEs: qualifying special purpose entities ("QSPEs") and variable interest entities ("VIEs"). The majority of the Company' s involvement with SPEs relates to securitization transactions meeting the SFAS 140 definition of a QSPE. A QSPE can generally be described as an entity with significantly limited powers that are intended to limit it to passively holding financial assets and distributing cash flows based on pre-set terms. Under SFAS 140, the Company is not required to, and does not, consolidate QSPEs. Rather, the Company accounts for its involvement with QSPEs under a financial components approach in which the Company recognizes only its retained involvement with the QSPE. The Company accounts for such retained interests at fair value with changes in fair value reported in earnings. FIN 46 does not alter the accounting for involvement with QSPEs.

The Company is a market leader in mortgage (both residential and commercial), municipal and other asset-backed securitizations that are principally transacted through QSPEs. The Company securitized approximately $173 billion of financial assets during 2003, including $138 billion of residential mortgages, $10 billion of commercial mortgages and $25 billion of municipal and other asset-backed financial assets. At November 30, 2003, the Company had approximately $1.0 billion of non-investment grade retained interests from its securitization activities. Retained interests are recorded in Securities and other inventory positions owned on the Consolidated Statement of Financial Condition and primarily represent junior interests in commercial and residential securitization transactions. The Company records its trading assets, including retained interests at fair value with related gains or losses recognized in Principal transactions in the Consolidated Statement of Income. (For additional information see Note 4 to the Consolidated Financial Statements.)

Certain SPEs do not meet the QSPE criteria due to their permitted activities not being sufficiently limited, or because the assets are not deemed qualifying financial instruments (e.g., real estate). FIN 46 defines entities that are not operating companies and that do not meet the QSPE criteria as VIEs. Under FIN 46, the Company is required to consolidate a VIE if it is deemed to be the primary beneficiary of such entity. The primary beneficiary is the party that has either a majority of the expected losses or a majority of the expected residual returns of such entity, as defined. FIN 46 is effective for the Company' s involvement with VIEs created after January 31, 2003. With respect to the Company' s involvement with SPEs established prior to February 1, 2003, the Company follows the accounting guidance

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

provided by Emerging Issues Task Force ("EITF") Topic D-14, *"Transactions involving Special-Purpose Entities,"* to determine whether consolidation is required. Under this guidance, the Company is not required to, and does not, consolidate such SPE if a third party investor made a substantive equity investment in the SPE (minimum of 3%), was subject to first-dollar risk of loss of such SPE, and had a controlling financial interest.

**Revenue Recognition Policies**

***Principal Transactions*** Securities and other inventory positions owned and Securities and other inventory positions sold but not yet purchased (both of which are recorded on a trade-date basis) are valued at market or fair value, as appropriate, with unrealized gains and losses reflected in Principal transactions in the Consolidated Statement of Income. The Company follows the American Institute of Certified Public Accountants ("AICPA") Audit and Accounting Guide, "Brokers and Dealers in Securities," (the "Guide") when determining market or fair value for financial instruments. Market value is generally determined based on listed prices or broker quotes. In certain instances, such price quotations may be deemed unreliable when the instruments are thinly traded or when the Company holds a substantial block of a particular security and the listed price is not deemed to be readily realizable. In accordance with the Guide, in these instances the Company determines fair value based on management' s best estimate giving appropriate consideration to reported prices and the extent of public trading in similar securities, the discount from the listed price associated with the cost at the date of acquisition, and the size of the position held in relation to the liquidity in the market, among other factors. When the size of the Company' s holding of a listed security is likely to impair the Company' s ability to realize the quoted market price, the Company records the position at a discount to the quoted price reflecting the Company' s best estimate of fair value. In such instances, fair value is generally determined with reference to the discount associated with the acquisition price of the security. When listed prices or broker quotes are not available, fair value is determined based on pricing models or other valuation techniques including the use of implied pricing from similar instruments. Pricing models are typically used to derive fair value based on the net present value of estimated future cash flows including adjustments, when appropriate, for liquidity, credit and/or other factors.

During the first quarter of 2003, the Company adopted EITF Issue No. 02-03, *"Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved In Energy Trading and Risk Management Activities"* ("EITF 02-03"). Under EITF 02-03, recognition of a trading profit at inception of a derivative transaction is prohibited unless the fair value of that derivative is obtained from a quoted market price, supported by comparison to other observable market transactions, or based on a valuation technique incorporating observable market data. The initial effect of adopting EITF 02-03 was not material to the Company' s financial condition or results of operations.

***Investment Banking*** Underwriting revenues fees and related revenues for merger, acquisition advisory and related services are recognized when services for the transactions are determined to be completed. Underwriting expenses are deferred and recognized when the related revenues are recognized.

***Commissions*** Commissions primarily include fees from executing and clearing client transactions on stock, options and futures markets worldwide. These fees are recognized on a trade-date basis.

***Investment Advisory Fees*** Investment advisory fees are recorded as earned. Generally, high-net-worth and institutional clients are charged or billed quarterly based on the account' s net asset value at the beginning of a quarter. Investment advisory and administrative fees earned from the Company' s mutual fund business (the "Funds") are charged monthly to the Funds based on average daily net assets under management.

***Interest Revenue/Expense*** The Company recognizes contractual interest on Securities and other inventory positions owned and Securities and other inventory positions sold but not yet purchased on an accrual basis as a component of Interest and dividends revenue and Interest expense, respectively. Interest flows on derivative transactions are included as part of the mark-to-market valuation of these contracts in Principal transactions and are not recognized as a component of interest revenue or expense. The Company accounts for its secured financing activities and short- and long-term borrowings on an accrual basis with related interest recorded as interest revenue or interest expense, as applicable.

**Securities and Other Inventory Positions**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Securities and other inventory positions owned and Securities and other inventory positions sold but not yet purchased are valued at market or fair value, as appropriate, with unrealized gains and losses reflected in Principal transactions in the Consolidated Statement of Income. At November 30, 2003 and 2002 all firm-owned securities pledged to counterparties that have the right, by contract or custom, to sell or repledge the securities are classified as Securities owned (pledged as collateral) as required by SFAS 140.

**Derivative Financial Instruments**

Derivatives are financial instruments whose value is based on an underlying asset (e.g., Treasury bond), index (e.g., S&P 500) or reference rate (e.g., LIBOR), such as futures, forwards, swaps, option contracts, or other financial instruments with similar characteristics. A derivative contract generally represents a future commitment to exchange interest payment streams or currencies based on the contract or notional amount or to purchase or sell other financial instruments at specified terms on a specified date. OTC derivative products are privately-negotiated contractual agreements that can be tailored to meet individual client needs and



include forwards, swaps and certain options including caps, collars and floors. Exchange-traded derivative products are standardized contracts transacted through regulated exchanges and include futures and certain option contracts listed on an exchange.

Derivatives are recorded at market or fair value in the Consolidated Statement of Financial Condition on a net-by-counterparty basis when a legal right of set-off exists and are netted across products when such provisions are stated in the master netting agreement. Derivatives are often referred to as off-balance sheet instruments because neither their notional amounts nor the underlying instruments are reflected as assets or liabilities of the Company. Instead, the market or fair values related to the derivative transactions are reported in the Consolidated Statement of Financial Condition as assets or liabilities in Derivatives and other contractual agreements, as applicable. Margin on futures contracts is included in receivables and payables from/to brokers, dealers and clearing organizations, as applicable. Changes in fair values of derivatives are recorded as Principal transactions revenue. Market or fair value is generally determined by either quoted market prices (for exchange-traded futures and options) or pricing models (for swaps, forwards and options). Pricing models use a series of market inputs to determine the present value of future cash flows with adjustments, as required, for credit risk and liquidity risk. Further valuation adjustments may be recorded, as deemed appropriate, for new or complex products or for positions with significant concentrations. These adjustments are integral components of the mark-to-market process. Credit-related valuation adjustments incorporate business and economic conditions, historical experience, concentrations, estimates of expected losses and the character, quality and performance of credit sensitive financial instruments.

As an end user, the Company primarily uses derivatives to modify the interest rate characteristics of its long-term debt and secured financing activities. The Company also uses equity derivatives to hedge its exposure to equity price risk embedded in certain of its debt obligations and foreign exchange forwards to manage the currency exposure related to its net investment in non-U.S. dollar functional currency operations (collectively, "End-User Derivative Activities"). The accounting for End-User Derivative Activities is dependent upon the nature of the hedging relationship. In certain hedging relationships both the derivative and the hedged item are marked to market through earnings ("fair value hedge"). In many instances, the hedge relationship is fully effective and the mark-to-market on the derivative and the hedged item offset. In other hedging relationships, the derivative is marked to market with the offsetting gains or losses recorded in Accumulated other comprehensive income, a component of Stockholders' Equity, until the related hedged item is recognized in earnings ("cash flow hedge"). Certain derivatives embedded in long-term debt are bifurcated from the debt and marked to market through earnings.

The Company principally uses fair value hedges to convert a substantial portion of the Company's fixed-rate debt and certain long-term secured financing activities to floating interest rates. Any hedge ineffectiveness in these relationships is recorded in Interest expense in the Consolidated Statement of Income. Gains or losses from revaluing foreign exchange contracts associated with hedging the Company's net investments in non-U.S. dollar functional currency operations are reported within Accumulated other comprehensive income in Stockholders' Equity. Unrealized receivables/payables resulting from the mark-to-market of end-user derivatives are included in Securities and other inventory positions owned or sold but not yet purchased.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In April 2003, the FASB issued SFAS No. 149, *"Amendment of Statement 133 on Derivative Instruments and Hedging Activities."* The statement amended and clarified the financial accounting and reporting for derivative instruments and for hedging activities under SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities,"* ("SFAS 133"). The adoption of the statement did not have a material effect on the Company' s financial condition or its results of operations.

**Secured Financing Activities**

***Repurchase and Resale Agreements*** Securities purchased under agreements to resell and Securities sold under agreements to repurchase, which are treated as financing transactions for financial reporting purposes, are collateralized primarily by government and government agency securities and are carried net by counterparty, when permitted, at the amounts at which the securities will be subsequently resold or repurchased plus accrued interest. It is the Company' s policy to take possession of securities purchased under agreements to resell. The Company monitors the market value of the underlying positions on a daily basis compared with the related receivable or payable balances, including accrued interest. The Company requires counterparties to deposit additional collateral or return collateral pledged, as necessary, to ensure the market value of the underlying collateral remains sufficient. Securities and other inventory positions owned that are financed under repurchase agreements are carried at market value with changes in market value recorded in the Consolidated Statement of Income.

The Company uses interest rate swaps as an end user to modify the interest rate exposure associated with certain fixed-rate resale and repurchase agreements. The Company adjusts the carrying value of these secured financing transactions that have been designated as the hedged item.

***Securities Borrowed and Loaned*** Securities borrowed and securities loaned are carried at the amount of cash collateral advanced or received plus accrued interest. It is the Company' s policy to value the securities borrowed and loaned on a daily basis and to obtain additional cash as necessary to ensure such transactions are adequately collateralized.

***Other Secured Borrowings*** Other secured borrowings are recorded at contractual amounts plus accrued interest.



**Private Equity Investments**

The Company carries its private equity investments, including its partnership interests, at fair value based on the Company' s assessment of each underlying investment.

**Long-Lived Assets**

Property, equipment and leasehold improvements are recorded at historical cost, net of accumulated depreciation and amortization. Depreciation is recognized using the straight-line method over the estimated useful lives of the assets. Buildings are depreciated up to a maximum of 40 years. Leasehold improvements are amortized over the lesser of their useful lives or the terms of the underlying leases, ranging up to 30 years. Equipment, furniture and fixtures are depreciated over periods of up to 15 years. Internal use software that qualifies for capitalization under AICPA Statement of Position 98-1, *"Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,"* is capitalized and subsequently amortized over the estimated useful life of the software, generally three years, with a maximum of seven years. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable. If the expected future undiscounted cash flows are less than the carrying amount of the asset, an impairment loss would be recognized to the extent the carrying value of such asset exceeded its fair value.

**Identifiable Intangible Assets and Goodwill**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

On December 1, 2001, the Company adopted SFAS No. 141, *"Business Combinations,"* ("SFAS 141") and SFAS No. 142, *"Goodwill and Other Intangible Assets"* ("SFAS 142"). SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS 142, intangible assets with indefinite lives and goodwill are not permitted to be amortized. Instead, these assets are evaluated at least annually for impairment. Prior to December 1, 2001 the Company amortized goodwill using the straight-line method over periods not exceeding 35 years. Goodwill is reduced upon the recognition of certain acquired net operating loss carryforward benefits.

**Equity-Based Compensation**

SFAS No. 123, *"Accounting for Stock-Based Compensation,"* ("SFAS 123") established financial accounting and reporting standards for equity-based employee and non-employee compensation. SFAS 123 permits companies to account for equity-based employee compensation using the intrinsic-value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, *"Accounting for Stock Issued to Employees,"* ("APB 25"), or using the fair-value method prescribed by SFAS 123. Through November 30, 2003 the Company followed APB 25 and its related interpretations to account for equity-based employee compensation. Accordingly, no compensation expense was recognized for stock option awards because the exercise price equaled or exceeded the market value of the Company' s common stock on the grant date. Compensation expense was recognized for restricted stock units with future service requirements over the relevant service periods.

Beginning in 2004, the Company will adopt the fair-value method of accounting for equity-based employee awards using the prospective transition method permitted by SFAS No. 148, *"Accounting for Stock-Based Compensation−Transition and Disclosure"* ("SFAS 148"). Under this method of transition, compensation expense will be recognized based on the fair value of stock options and restricted stock units granted for 2004 and future years over the related service period. Stock options granted for the years ended November 30, 2003 and before will continue to be accounted for under APB 25. The following table illustrates the effect on net income and earnings per share for the years ended November 30, 2003, 2002 and 2001 if the fair-value-based method prescribed by SFAS 123 had been applied to all outstanding and unvested awards:

**EQUITY BASED COMPENSATION− PRO FORMA NET INCOME AND EARNINGS PER SHARE**

| IN MILLIONS EXCEPT PER SHARE DATA<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| Net income, as reported | **$ 1,699** | $ 975 | $ 1,255 |
| Add: stock-based employee compensation expense included in reported net income, net of related tax effect | **362** | 330 | 303 |
| Deduct: stock-based employee compensation expense determined under the fair-value-based method for all awards, net of related tax effect | **(534)** | (475) | (375) |
| Pro forma net income | **$ 1,527** | $ 830 | $ 1,183 |
| Earnings per share: | | | |
| Basic, as reported | **$ 6.71** | $ 3.69 | $ 4.77 |
| Basic, pro forma | **$ 6.01** | $ 3.10 | $ 4.48 |
| Diluted, as reported | **$ 6.35** | $ 3.47 | $ 4.38 |
| Diluted, pro forma | **$ 5.77** | $ 2.95 | $ 4.20 |



The Company used the Black-Scholes option-pricing model to quantify the pro forma effects on net income and earnings per common share of the fair value of the stock options granted and outstanding during 2003, 2002 and 2001. Based on the results of the model, the weighted-average fair values of the stock options granted were $22.02, $19.07 and $13.54 for 2003, 2002 and 2001, respectively. The weighted-average assumptions used for 2003, 2002 and 2001 included risk-free interest rates of 3.10%, 3.26% and 4.16%, expected lives of

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

4.6 years, 5.3 years and 4.5 years, and expected volatilities of 35%, 35% and 30%, respectively. In addition, annual dividends per share of $0.48, $0.36 and $0.28 were used for the 2003, 2002 and 2001 options, respectively. The pro forma amounts reflect the effects of the Company' s stock option grants and the 15% purchase discount from market value offered to the Company' s employees who participate in the Employee Stock Purchase Plan. Had the Company elected to expense its stock options in 2003 under the prospective alternative of SFAS 148, net income and earnings per share would have decreased by $40 million and $0.15 per share, respectively. The Company' s stock-based employee compensation plans are described more fully in Note 15 to the Consolidated Financial Statements.

**Earnings per Common Share**

The Company computes earnings per common share ("EPS") in accordance with SFAS No. 128, *"Earnings per Share."* Basic EPS is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the assumed conversion of all dilutive securities. For additional information see Notes 14 and 16 to the Consolidated Financial Statements.

**Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, *"Accounting for Income Taxes,"* ("SFAS 109"). The Company recognizes the current and deferred tax consequences of all transactions that have been recognized in the financial statements using the provisions of the enacted tax laws. Deferred tax assets are recognized for temporary differences that will result in deductible amounts in future years and for tax loss carry-forwards. The Company records a valuation allowance to reduce deferred tax assets to an amount that more likely than not will be realized. Deferred tax liabilities are recognized for temporary differences that will result in taxable income in future years.

**Statement of Cash Flows**

The Company defines cash equivalents as highly liquid investments with original maturities of three months or less, other than those held for sale in the ordinary course of business.

**Translation of Foreign Currencies**

Assets and liabilities of foreign subsidiaries having non-U.S. dollar functional currencies are translated at exchange rates at the Consolidated Statement of Financial Condition date. Revenues and expenses are translated at average exchange rates during the period. The gains or losses resulting from translating foreign currency financial statements into U.S. dollars, net of hedging gains or losses and taxes, are included in Accumulated other comprehensive income, a component of Stockholders' equity. Gains or losses resulting from foreign currency transactions are included in the Consolidated Statement of Income.

## NOTE 2 SECURITIES AND OTHER INVENTORY POSITIONS

Securities and other inventory positions owned and Securities and other inventory positions sold but not yet purchased are recorded at fair value and were comprised of the following:

**SECURITIES AND OTHER INVENTORY POSITIONS**

| IN MILLIONS<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | |
|---|---|---|---|---|
| Securities and other inventory positions owned: | | | | |
| Mortgages, mortgage-backed and real estate inventory positions | **$** | **38,957** | $ | 34,431 |
| Government and agencies | | **35,072** | | 28,543 |
| Derivatives and other contractual agreements | | **15,766** | | 13,862 |
| Corporate debt and other | | **20,069** | | 15,620 |
| Corporate equities | | **22,889** | | 21,252 |
| Certificates of deposit and other money market instruments | | **4,287** | | 5,570 |
| | **$** | **137,040** | $ | 119,278 |
| | | | | |
| Securities and other inventory positions sold but not yet purchased: | | | | |
| Government and agencies | **$** | **47,556** | $ | 40,852 |
| Derivatives and other contractual agreements | | **11,440** | | 10,126 |
| Corporate debt and other | | **5,951** | | 8,927 |
| Corporate equities | | **10,935** | | 9,129 |
| | **$** | **75,882** | $ | 69,034 |



## NOTE 3 DERIVATIVE FINANCIAL INSTRUMENTS

In the normal course of business, the Company enters into derivative transactions both in a trading capacity and as an end-user. The Company' s derivative activities (both trading and end-user) are recorded at fair value in the Consolidated Statement of Financial Condition. Acting in a trading capacity, the Company enters into derivative transactions to satisfy the needs of its clients and to manage its own exposure to market and credit risks resulting from its trading activities (collectively, "Trading-Related Derivative Activities"). As an end-user, the Company primarily enters into interest rate swap and option contracts to adjust the interest rate nature of its funding sources from fixed to floating rates and to change the index upon which floating interest rates are based (e.g., Prime to LIBOR).

Derivatives are subject to various risks similar to other financial instruments, including market, credit and operational risk. In addition, the Company may be exposed to legal risks related to its derivative activities, including the possibility a transaction may be unenforceable under applicable law. The risks of derivatives should not be viewed in isolation, but rather should be considered on an aggregate basis along with the Company' s other trading-related activities. The Company manages the risks associated with derivatives on an aggregate basis along with the risks associated with its proprietary trading and market-making activities in cash instruments, as part of its firmwide risk management policies.

The Company records its Trading-Related Derivative Activities at fair value with realized and unrealized gains and losses recognized in Principal transactions in the Consolidated Statement of Income. Unrealized gains and losses on derivative contracts are recorded on a net basis in the Consolidated Statement of Financial Condition for those transactions with counterparties executed under a legally enforceable master netting agreement and are netted across products when such provisions are stated in the master netting agreement. The Company offers equity, fixed income and foreign exchange products to its customers. Because of the integrated nature of the market for such products, each product area trades cash instruments as well as derivative products.

The following table presents the fair value of the Company' s derivatives at November 30, 2003 and 2002. Assets included in the table represent unrealized gains, net of unrealized losses for situations in which the Company has a master netting agreement. Similarly, liabilities represent net amounts owed to counterparties. The fair value of assets/liabilities related to derivative contracts at November 30, 2003 and 2002 represents the Company' s net receivable/payable for derivative financial instruments before consideration of collateral. Included within the $15,766 million fair value of assets at November 30, 2003 was $13,567 million related to swaps and other OTC contracts and $2,199 million related to exchange-traded option and warrant contracts. Included within the $13,862 million fair value of assets at November

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

30, 2002 was $12,846 million related to swaps and other OTC contracts and $1,016 million related to exchange-traded option and warrant contracts.

### FAIR VALUE OF DERIVATIVES AND OTHER CONTRACTUAL AGREEMENTS

| IN MILLIONS | Fair Value (1) November 30, 2003 | | Fair Value (1) November 30, 2002 | |
|---|---|---|---|---|
| | Assets | Liabilities | Assets | Liabilities |
| Interest rate, currency and credit default swaps and options (including caps, collars and floors) | **$ 7,602** | **$ 5,614** | $ 9,046 | $ 7,087 |
| Foreign exchange forward contracts and options | **1,807** | **1,982** | 814 | 1,157 |
| Other fixed income securities contracts (including futures contracts, options and TBAs) | **1,264** | **750** | 602 | 215 |
| Equity contracts (including equity swaps, warrants and options) | **5,093** | **3,094** | 3,400 | 1,667 |
| | **$ 15,766** | **$ 11,440** | $ 13,862 | $ 10,126 |

(1) Amounts represent carrying value (exclusive of collateral) and do not include receivables or payables related to exchange-traded futures contracts.



The primary difference in risks between OTC and exchange-traded contracts is credit risk. OTC contracts contain credit risk for unrealized gains, net of collateral, from various counterparties for the duration of the contract. With respect to OTC contracts, including swaps, the Company views its net credit exposure to third parties to be $9,457 million and $8,223 million at November 30, 2003 and 2002, respectively, representing the fair value of the Company' s OTC contracts in an unrealized gain position, after consideration of collateral.

Presented below is an analysis of the Company' s net credit exposure at November 30, 2003 for OTC contracts based on actual ratings made by external rating agencies or by equivalent ratings established and used by the Company' s Credit Risk Management Department.

### NET CREDIT EXPOSURE

| Counterparty Risk Rating | S&P/Moody' s Equivalent | Less than 1 Year | 1-5 Years | 5-10 Years | Greater than 10 Years | Total 2003 | Total 2002 |
|---|---|---|---|---|---|---|---|
| 1 | AAA/Aaa | 6% | 3% | 3% | 3% | **15%** | 15% |
| 2 | AA-/Aa3 or higher | 12% | 5% | 6% | 7% | **30%** | 30% |
| 3 | A-/A3 or higher | 11% | 9% | 5% | 9% | **34%** | 33% |
| 4 | BBB-/Baa3 or higher | 5% | 5% | 2% | 6% | **18%** | 17% |
| 5 | BB-/Ba3 or higher | 1% | – | 1% | – | **2%** | 4% |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| 6 | B+/B1 or lower | 1% | – | – | – | **1%** | 1% |
|---|---|---|---|---|---|---|---|
| Total | | 36% | 22% | 17% | 25% | **100%** | 100% |

Counterparties to the Company' s OTC derivative products are primarily financial intermediaries (U.S. and foreign banks), securities firms, corporations, governments and their agencies, finance companies, insurance companies, investment companies and pension funds. Collateral held related to OTC contracts generally includes cash and U.S. government and federal agency securities.

The Company is also subject to credit risk related to its exchange-traded derivative contracts. Exchange-traded contracts, including futures and certain options, are transacted directly on exchanges. To protect against the potential for a default, all exchange clearinghouses impose net capital requirements for their membership. Additionally, exchange clearinghouses require counterparties to futures contracts to post margin upon the origination of the contracts and for any changes in the market value of the contracts on a daily basis (certain foreign exchanges provide for settlement within three days). Therefore, the potential for credit losses from exchange-traded products is limited.

**End-User Derivative Activities**

The Company uses a variety of derivative products for non-trading purposes as an end user to modify the interest rate characteristics of its long-term debt portfolio and certain secured financing activities. In this regard, the Company primarily enters into fair value hedges using interest rate swaps to convert a substantial portion of its fixed rate long-term debt and certain term fixed-rate secured financing activities to floating interest rates. The ineffective portion of the fair value hedges was included in Interest expense in the Consolidated Statement of Income and was not material to the Company' s results for the years ended November 30, 2003, 2002 and 2001. At November 30, 2003 and 2002, the notional amounts of the Company' s End-User Derivative Activities related to its long-term debt obligations were approximately $57.6 billion and $49.1 billion, respectively. (For additional information about Company' s long-term-debt-related End-User Derivative Activities see Note 9 to the Consolidated Financial Statements.)

The Company also uses derivative products as an end-user to modify its interest rate exposure associated with its secured financing activities, including Securities purchased under agreements to resell, Securities borrowed, Securities sold under agreements to repurchase, Securities loaned and Other secured borrowings. As with the Company' s long-term debt, its secured financing activities expose the Company to interest rate risk. The Company, as an end-user, manages the interest rate risk related to these activities by using derivative financial instruments, including interest rate swaps and purchased options. The Company designates certain specific derivative transactions as hedges of specific assets and liabilities with matching maturities. At November 30, 2003 and 2002, the Company, as an end-user, used derivative financial instruments with an aggregate notional amount of $8.1 billion and $6.9 billion, respectively, to modify the interest rate characteristics of its secured financing activities. The total notional amount of these agreements had a weighted-average maturity of 4.5 years and 5.3 years at November 30, 2003 and 2002, respectively.



**NOTE 4 SECURITIZATIONS AND OTHER OFF-BALANCE SHEET ARRANGEMENTS**

The Company is a market leader in mortgage- and asset-backed securitizations and other structured financing arrangements. In connection with these activities, the Company uses SPEs principally for (but not limited to) the securitization of commercial and residential mortgages, home equity loans, government and corporate bonds, and lease and trade receivables. The majority of the Company' s involvement with SPEs relates to securitization transactions meeting the SFAS 140 definition of a QSPE. Based on the guidance in SFAS 140, the Company does not consolidate such QSPEs. The Company derecognizes financial assets transferred in securitizations, provided it has relinquished control over such assets. The Company may retain an interest in the financial assets it securitizes ("retained interests"), which may include assets in the form of residual interests in the SPEs established to facilitate the securitization. Any retained interests are included in Securities and other inventory positions owned (principally Mortgages and mortgage-backed) in the Consolidated Statement of Financial Condition. For further information regarding the accounting for securitization transactions, refer to Note 1, Summary of Significant Accounting

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Policies−Consolidation Accounting Policies. During 2003, 2002 and 2001, the Company securitized approximately $173 billion, $155 billion and $110 billion of financial assets, including $138 billion, $108 billion and $50 billion of residential mortgages, $10 billion, $15 billion and $11 billion of commercial mortgages and $25 billion, $32 billion and $49 billion of municipal and other asset-backed financial instruments, respectively.

At November 30, 2003 and 2002, the Company had approximately $1.0 billion and $1.1 billion, respectively, of non-investment grade retained interests from its securitization activities (principally junior security interests in securitizations) including $0.2 billion and $0.5 billion of commercial mortgages, $0.6 billion and $0.4 billion of residential mortgages, and $0.2 billion and $0.2 billion of other asset-backed financial instruments, respectively. The Company records its trading assets at fair value, including those assets held prior to securitization, as well as any retained interests post-securitization. Mark-to-market gains or losses are recorded in Principal transactions in the Consolidated Statement of Income. Fair value is determined based on listed market prices, if available. When market prices are not available, fair value is determined based on valuation pricing models that take into account relevant factors such as discount, credit and prepayment assumptions, and also considers comparisons to similar market transactions.

The tables below outline the key economic assumptions used in measuring the fair value of retained interests:

| **November 30, 2003** | **Residential Mortgages** | **Commercial Mortgages** | **Other Asset-Backed** |
|---|---|---|---|
| Weighted-average life | **4 years** | **1 year** | **7 years** |
| Annual prepayment rate | **5 - 90 CPR** | **0 - 15 CPR** | **0 - 12 CPR** |
| Credit loss assumption | **0.5 - 7%** | **2 - 27%** | **3 - 12%** |
| Weighted-average discount rate | **21%** | **17%** | **3%** |

| **November 30, 2002** | **Residential Mortgages** | **Commercial Mortgages** | **Other Asset-Backed** |
|---|---|---|---|
| Weighted-average life | 3 years | 1 year | 5 years |
| Annual prepayment rate | 4 - 65 CPR | 0 - 15 CPR | 8 - 15 CPR |
| Credit loss assumption | 0.5 - 6% | 2 - 17% | 3 - 10% |
| Weighted-average discount rate | 17% | 20% | 5% |



The table below outlines the sensitivity of the fair value of the retained interests to immediate 10% and 20% adverse changes in the preceding assumptions:

| | **November 30, 2003** | | | **November 30, 2002** | | |
|---|---|---|---|---|---|---|
| **IN MILLIONS** | **Residential Mortgages** | **Commercial Mortgages** | **Other Asset-Backed** | **Residential Mortgages** | **Commercial Mortgages** | **Other Asset-Backed** |
| Prepayment speed: | | | | | | |
| Impact of 10% adverse change | **$ 2** | **$ −** | **$ −** | $ 4 | $ − | $ 1 |
| Impact of 20% adverse change | **$ 5** | **$ −** | **$ −** | $ 8 | $ − | $ 2 |
| Assumed credit losses: | | | | | | |
| Impact of 10% adverse change | **$ 21** | **$ 6** | **$ 9** | $ 17 | $ − | $ 12 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | | |
|---|---|---|---|---|---|---|
| Impact of 20% adverse change | **$ 40** | **$ 6** | **$ 18** | $ 33 | $ 12 | $ 24 |
| Discount rate: | | | | | | |
| Impact of 10% adverse change | **$ 25** | **$ –** | **$ 23** | $ 17 | $ – | $ 12 |
| Impact of 20% adverse change | **$ 49** | **$ –** | **$ 45** | $ 34 | $ – | $ 24 |

The sensitivity analysis in the preceding table is hypothetical and should be used with caution because the above stresses are performed without considering the effect of hedges, which serve to reduce the Company' s actual risk. In addition, these results are calculated by stressing a particular economic assumption independent of changes in any other assumption (as required by U.S. GAAP); in reality, changes in one factor often result in changes in another factor (for example, changes in discount rates will often impact expected prepayment speeds). Further, changes in the fair value based on a 10% or 20% variation in an assumption should not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear.

The following table summarizes cash flows between the Company and securitization trusts:

| **IN MILLIONS**<br>**YEAR ENDED NOVEMBER 30, 2003** | **Residential Mortgages** | **Commercial Mortgages** | **Other Asset-Backed** |
|---|---|---|---|
| Purchases of delinquent loans | **$ 155** | **$ –** | **$ –** |
| Cash flows received on retained interests | **$ 214** | **$ 11** | **$ 111** |

Substantially all of the Company' s residential and commercial securitization activities are transacted through QSPEs. The Company also securitizes municipal bonds through QSPEs in which the Company sells municipal bonds to an SPE and generally purchases a junior interest in such securitization. At November 30, 2003, the Company also had liquidity commitments of approximately $5.1 billion related to trust certificates in such SPEs backed by investment grade municipal securities. The Company' s obligations under such liquidity commitments are generally less than one year and are further limited because the Company' s obligations cease if the underlying assets are downgraded below investment grade or default.

However, certain SPEs do not meet the QSPE criteria due to their permitted activities not being sufficiently limited, or because the assets are not deemed qualifying financial instruments (e.g., real estate). FIN 46 defines entities in which equity investors do not have the characteristics of a controlling financial interest or entities which do not have sufficient legal equity at risk for the entity to finance its activities without additional subordinated financial support from other parties as VIEs. Under FIN 46, the Company is required to consolidate a VIE if it is deemed to be the primary beneficiary of such entity. The primary beneficiary is the party that has either a majority of the expected losses or a majority of the expected residual returns



of such entity, as defined. FIN 46 is effective for the Company' s involvement with VIEs created after January 31, 2003. With respect to the Company' s involvement with SPEs established prior to February 1, 2003, the Company follows the accounting guidance provided by EITF Topic D-14, *"Transactions involving Special-Purpose Entities,"* to determine whether consolidation is required. Under this guidance, the Company is not required to, and does not consolidate such SPE if a third party investor made a substantive equity investment in the SPE (minimum of 3%), was subject to first dollar risk of loss of such SPE, and had a controlling financial interest. Examples of the Company' s involvement with such VIEs include: collateralized debt obligations ("CDOs"), synthetic credit transactions, and other structured financing transactions.

With respect to CDO transactions in which a diversified portfolio of securities and/or loans is owned by an SPE and managed by an independent asset manager, the Company' s role is principally limited to acting as structuring and placement agent, warehouse provider,

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

underwriter and market maker in the related CDO securities. In a typical CDO, at the direction of a third party asset manager, the Company will warehouse securities or loans on its balance sheet, pending the transfer to the SPE once the permanent financing is completed in the capital markets. During 2003, the Company acted as warehouse provider and underwriter for approximately $601 million of CDO transactions. At November 30, 2003, the Company did not have any significant continuing involvement in the CDOs arranged by the Company other than acting as market maker (i.e., holding minority amounts of investment grade securities purchased in the secondary markets for short time periods) and, as such, the Company is not required to consolidate these transactions. At November 30, 2003, the Company' s holdings of subordinated classes in such CDO transactions was not material.

The Company is a dealer in credit default swaps and, as such, makes a market in buying and selling credit protection on single issuers as well as on portfolios of credit exposures. One of the mechanisms used by the Company to mitigate credit risk is synthetic credit transactions entered into with SPEs. In these transactions, the Company purchases credit protection in the form of a credit default swap from the SPE on referenced obligations (single issuer or portfolio). The Company pays a premium to the SPE for this protection and is secured by high quality collateral purchased by the SPE. Third party investors in these SPEs are subject to default risk associated with the referenced obligations under the default swap as well as credit risk to the assets held by the SPE. The Company' s maximum loss associated with its involvement with such synthetic credit transactions is the fair value of the Company' s credit default swaps with such SPEs, which approximated $229 million at November 30, 2003. While this amount represents the maximum amount the Company could potentially lose on such agreements, the maximum loss is highly unlikely because the value of the underlying collateral held by the SPEs was $6.6 billion and was investment grade quality. Since the results of our expected loss calculations generally demonstrate that the investors in the SPE bear a majority of the entity' s expected losses (as the investors assume default risk associated with both the reference portfolio and the SPE' s assets), the Company is not deemed to be the primary beneficiary of these transactions and as such does not consolidate under FIN 46.

The Company also enters into certain structured financing transactions with SPEs to facilitate customers' investment and/or funding needs. The Company' s involvement in these transactions is generally limited to providing liquidity or other limited default protection to investors. In this regard, the Company provided liquidity protection to SPEs of approximately $0.7 billion and $3.3 billion as of November 30, 2003 and 2002, respectively. The Company' s maximum loss associated with such commitments is $0.7 billion at November 30, 2003, however the Company believes its actual risk to be significantly less as these liquidity commitments are generally overcollateralized with investment grade collateral. The Company anticipates consolidating such entities upon adoption of FIN 46 in the first quarter of 2004. In addition, the Company also provides certain limited downside default protection to investors in SPEs. The Company' s maximum loss under such commitments was approximately $1.8 billion and $1.6 billion, at November 30, 2003 and 2002, respectively. As the investor in such SPE bears all upside potential and significant downside variability, the Company is not deemed to be the primary beneficiary of these entities and as such does not expect to consolidate upon adoption of FIN 46 in the first quarter of 2004. The Company believes its actual exposure to be significantly less than the maximum exposure disclosed above, as the Company' s obligations are collateralized by the SPEs' assets and contain significant constraints under which such downside protection will be available.

In December 2003, the FASB issued a revised interpretation of FIN 46 that clarifies certain of the original interpretation' s provisions. While the Company has not yet completed its analysis of FIN 46 as revised, the Company does not anticipate that the adoption of the interpretation will have a material impact on the Company' s financial condition or its results of operations.



---

**NOTE 5 SECURITIES PLEDGED AS COLLATERAL**

The Company enters into secured borrowing and lending transactions to finance trading inventory positions, obtain securities for settlement and meet customers' needs. The Company receives collateral in connection with resale agreements, securities borrowed transactions, customer margin loans and certain other loans. The Company is generally permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, enter into securities lending transactions or deliver to counterparties to cover short positions. The Company carries secured financing agreements for financial reporting purposes on a net basis when permitted under the provisions of Financial Accounting Standards Board Interpretation No. 41, *"Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements"* ("FIN 41").

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

At November 30, 2003 and 2002, the fair value of securities received as collateral and securities owned that have not been sold, repledged or otherwise encumbered totaled approximately $67 billion and $51 billion, respectively. At November 30, 2003 and 2002, the gross fair value of securities received as collateral that the Company was permitted to sell or repledge was approximately $413 billion and $345 billion, respectively. Of this collateral, approximately $385 billion and $328 billion at November 30, 2003 and 2002, respectively, has been sold or repledged, generally as collateral under repurchase agreements or to cover Securities and other inventory positions sold but not yet purchased. Included in the $385 billion and $328 billion at November 30, 2003 and 2002, respectively, the Company had pledged securities, primarily fixed income, having a market value of approximately $55.5 billion and $41.6 billion, respectively, as collateral for securities borrowed having a market value of approximately $54.7 billion and $40.6 billion, respectively.

The Company also pledges its own assets, principally to collateralize certain financing arrangements. These pledged securities, where the counterparty has the right, by contract or custom, to rehypothecate the financial instruments are classified as Securities and other inventory positions owned, pledged as collateral, in the Consolidated Statement of Financial Condition as required by SFAS 140.

The carrying value of Securities and other inventory positions owned that have been pledged or otherwise encumbered to counterparties where those counterparties do not have the right to sell or repledge was approximately $47 billion and $49 billion at November 30, 2003 and November 30, 2002, respectively.

## NOTE 6 BUSINESS COMBINATIONS

On October 31, 2003, the Company acquired Neuberger Berman Inc. and its subsidiaries (“Neuberger”) by means of a merger into a wholly-owned subsidiary of Holdings. The results of Neuberger’ s operations are included in the consolidated financial statements since that date. Neuberger is an investment advisory company that engages in wealth management services including private asset management, tax and financial planning, and personal and institutional trust services, mutual funds, institutional management and alternative investments, and professional securities services.

The Company purchased Neuberger for a net purchase price of approximately $2,788 million, including cash consideration and incidental costs of $690 million, equity consideration of $2,374 million (including 32.3 million shares of common stock, 0.3 million shares of restricted common stock and 3.5 million vested stock options) and excluding net cash and short-term investments acquired of $276 million. The Company also issued approximately 0.5 million shares of restricted common stock valued at $42 million, which is subject to future service requirements and will be amortized over the applicable service periods (for additional information see Note 15 to the Consolidated Financial Statements). The value of the common shares issued that was used to record the transaction was determined based on the average closing market price of the Company’ s common shares from October 27, 2003 through October 31, 2003. The vested stock options issued were valued using the Black-Scholes option-pricing model and had a weighted-average life of approximately seven years and a weighted-average exercise price of $60.10. At November 30, 2003 approximately 3.1 million options with a weighted-average remaining life of approximately seven years and a weighted-average exercise price of $62.61 remain outstanding.



The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at October 31, 2003, the date of acquisition. The Company is obtaining third party valuations of certain intangible assets and the allocation of the purchase price therefore is subject to refinement.

| **IN MILLIONS** | | |
|---|---|---|
| Cash, receivables and financial instruments | **$** | **2,717** |
| Fixed and other assets | | **212** |
| Amortizable intangible assets | | **431** |
| Indefinite-life intangible assets | | **520** |
| Goodwill | | **2,254** |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | |
|---|---|---|
| Total assets acquired | $ | 6,134 |
| | | |
| Liabilities and financial instruments | $ | (2,469) |
| Deferred tax liability | | (420) |
| Long-term debt | | (181) |
| Total liabilities assumed | $ | (3,070) |

The $431 million of acquired amortizable intangible assets have a weighted-average useful life of approximately 20 years. The amortizable intangible assets include computer software of $29 million (five-year weighted-average useful life) and customer lists of $402 million (21 year weighted-average useful life). Indefinite-life intangible assets consist of the Neuberger Berman trade name and mutual fund customer-related intangibles. The $2,254 million of goodwill was assigned to the Client Services business segment. Of that amount approximately $125 million is expected to be deductible for tax purposes.

During 2003, the Company also acquired two originators and servicers of residential loans, The Crossroads Group, a diversified private equity fund investment manager, and the fixed income asset management business of Lincoln Asset Management, for an aggregate total cost of $172 million, which was paid in cash and notes.

Goodwill recognized in those transactions amounted to $113 million, substantially all of which is related to The Crossroads Group, and is expected to be deductible for tax purposes. Goodwill was assigned to the Capital Markets and Client Services business segments in the amounts of $19 million and $94 million, respectively.

The following table sets forth the unaudited pro forma combined operating results of the Company for the years ended November 30, 2003 and 2002 as if the acquisitions discussed above had been completed at the beginning of 2003 and 2002. These pro forma amounts do not consider any anticipated revenue or expense saving synergies. In addition, the Neuberger acquisition occurred at October 31, 2003 when Neuberger assets under management totaled approximately $68 billion while assets under management at the beginning of the year totaled only $56 billion.

| IN MILLIONS, EXCEPT PER SHARE AMOUNTS | 2003 | 2002 |
|---|---|---|
| Net revenues | $ 9,383 | $ 6,981 |
| Net income | 1,722 | 1,014 |
| Basic earnings per share | 6.24 | 3.64 |
| Diluted earnings per share | 5.93 | 3.44 |

## NOTE 7 IDENTIFIABLE INTANGIBLE ASSETS AND GOODWILL

The table below presents information about the Company' s acquired intangible assets at November 30, 2003.

Aggregate amortization expense for the years ended November 30, 2003, 2002 and 2001 was $11 million, $5 million and $13 million, respectively. Estimated amortization expense for the years ending November 30, 2004, 2005, 2006, 2007 and 2008 is $36 million, $36 million, $36 million, $35 million and $28 million, respectively.

| IN MILLIONS NOVEMBER 30, 2003 | Gross Carrying Amount | Accumulated Amortization |
|---|---|---|
| Amortizable intangible assets: | | |
| Customer lists | $ 448 | $ 11 |
| Other | 100 | 23 |
| Total | $ 548 | $ 34 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| Unamortizable intangible assets: | |
| Mutual fund customer-related intangibles | **$ 395** |
| Trade name | **125** |
| Total | **$ 520** |



The changes in the carrying amount of goodwill for the year ended November 30, 2003, are as follows:

**GOODWILL**

| IN MILLIONS | Capital Markets | Client Services | Total |
|---|---|---|---|
| Balance (net) at November 30, 2002 | $ 135 | $ 25 | $ 160 |
| Goodwill acquired during the year | 19 | 2,348 | 2,367 |
| Balance (net) at November 30, 2003 | $ 154 | $ 2,373 | $ 2,527 |

## NOTE 8 SHORT-TERM FINANCINGS

The Company obtains short-term financing on both a secured and unsecured basis. Secured financing is obtained through the use of repurchase agreements and securities loaned agreements, which are primarily collateralized by government, government agency and equity securities. The unsecured financing is generally obtained through short-term debt and the issuance of commercial paper.

The Company' s commercial paper and short-term debt financing is comprised of the following:

**SHORT-TERM DEBT**

| IN MILLIONS<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| Commercial paper | **$ 1,559** | $ 1,622 |
| Short-term debt: | | |
| Secured bank loans | **16** | 457 |
| Payables to banks | **149** | 95 |
| Other short-term debt (1) | **607** | 195 |
| Commercial paper and short-term debt | **$ 2,331** | $ 2,369 |

(1) Includes master notes, corporate loans and other short-term financings.

At November 30, 2003 and 2002, the weighted-average interest rates for short-term borrowings, including commercial paper, were 1.2% and 1.7%, respectively. The Company' s short-term financing includes $324 million and $116 million of short-term debt at November 30, 2003 and 2002, respectively, related to non-U.S. dollar obligations.

**Credit Facilities**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Holdings maintains a revolving credit agreement (the "Credit Agreement") with a syndicate of banks. Under the Credit Agreement, the banks have committed to provide up to $1 billion through April 2005. The Credit Agreement contains covenants that require, among other things, that the Company maintain a specified level of tangible net worth. The Company views the Credit Agreement as one of its many sources of liquidity available through its funding framework, and, as such, the Company uses this liquidity for general business purposes from time to time. The Company also maintains a $750 million multi-currency revolving credit facility for Lehman Brothers Bank AG (LBBAG) (the "Facility"). The Facility has a term of 364 days expiring on October 27, 2004, with an option to extend payment for an additional 364 days. There were no borrowings outstanding under either the Credit Agreement or the Facility at November 30, 2003, although drawings have been made under both and repaid from time to time during the year. The Company has maintained compliance with the applicable covenants for both the Credit Agreement and the Facility at all times.



## NOTE 9 LONG-TERM DEBT

### LONG-TERM DEBT

| IN MILLIONS NOVEMBER 30 | U.S. Dollar Fixed Rate | U.S. Dollar Floating Rate | Non-U.S. Dollar Fixed Rate | Non-U.S. Dollar Floating Rate | 2003 | 2002 |
|---|---|---|---|---|---|---|
| **SENIOR NOTE** | | | | | | |
| Maturing in fiscal 2003 | $ – | $ – | $ – | $ – | **$ –** | $ 7,484 |
| Maturing in fiscal 2004 | 1,719 | 3,081 | 1,465 | 1,153 | **7,418** | 7,246 |
| Maturing in fiscal 2005 | 2,010 | 2,723 | 340 | 1,695 | **6,768** | 4,180 |
| Maturing in fiscal 2006 | 2,871 | 1,584 | 854 | 1,275 | **6,584** | 4,791 |
| Maturing in fiscal 2007 | 1,560 | 418 | 1,649 | 1,028 | **4,655** | 4,206 |
| Maturing in fiscal 2008 | 3,579 | 1,159 | 104 | 1,283 | **6,125** | 2,017 |
| December 1, 2008 and thereafter | 5,361 | 708 | 1,273 | 2,411 | **9,753** | 6,359 |
| Senior Notes | $ 17,100 | $ 9,673 | $ 5,685 | $ 8,845 | **$ 41,303** | $ 36,283 |
| **SUBORDINATED INDEBTEDNESS** | | | | | | |
| Maturing in fiscal 2003 | $ – | $ – | $ – | $ – | **$ –** | $ 487 |
| Maturing in fiscal 2004 | 191 | 35 | – | – | **226** | 444 |
| Maturing in fiscal 2005 | 102 | – | 3 | – | **105** | 115 |
| Maturing in fiscal 2006 | 331 | – | – | – | **331** | 337 |
| Maturing in fiscal 2007 | 334 | – | 10 | – | **344** | 347 |
| Maturing in fiscal 2008 | 661 | 111 | – | – | **772** | 665 |
| December 1, 2008 and thereafter | 333 | 115 | – | – | **448** | – |
| Subordinated Indebtedness | 1,952 | 261 | 13 | – | **2,226** | 2,395 |
| Long-Term Debt | $ 19,052 | $ 9,934 | $ 5,698 | $ 8,845 | **$ 43,529** | $ 38,678 |

Of the Company' s long-term debt outstanding at November 30, 2003, $771 million is repayable prior to maturity, at the option of the holder, at par value. These obligations are reflected in the above table as maturing at their put dates, in fiscal 2004, rather than at their contractual maturities, which range from fiscal 2004 to fiscal 2026. In addition, $3,164 million of the Company' s long-term debt is redeemable prior to maturity at the option of the Company under various terms and conditions. These obligations are reflected in the above table at their contractual maturity dates.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

At November 30, 2003, the Company' s U.S. dollar and non-U.S. dollar debt portfolios included approximately $3,631 million and $4,855 million, respectively, of debt for which the interest rates and/or redemption values have been linked to the performance of various indices, including industry baskets of stocks, commodities or events. Generally, such notes are issued as floating rate notes or the interest rates on such index notes are effectively converted to floating rates based primarily on LIBOR through the use of interest rate, currency and equity swaps.

**End-User Derivative Activities**

The Company uses a variety of derivative products including interest rate, currency and equity swaps as an end user to modify the interest rate characteristics of its long-term debt portfolio. The Company uses interest rate swaps to convert a substantial portion of the Company' s fixed rate debt to floating interest rates to more closely match the terms of assets being funded and to minimize interest rate risk. In addition, the Company uses cross-currency swaps to hedge its exposure to foreign currency risk as a result of its non-U.S. dollar debt obligations, after consideration of non-U.S. dollar assets that are funded with long-term debt obligations in the same currency. In certain instances, two or more derivative contracts may be used by the Company to manage the interest rate nature and/or currency exposure of an individual long-term debt issuance.

At November 30, 2003 and 2002, the notional amounts of interest rate, currency and equity swaps related to long-term debt obligations were approximately $57.6 billion and $49.1 billion, respectively. In addition, End-User Derivative Activities resulted in the following changes to the mix of fixed and floating rate debt and effective weighted-average rates of interest:



**EFFECTIVE WEIGHTED-AVERAGE INTEREST RATES OF LONG-TERM DEBT**

| IN MILLIONS NOVEMBER 30, 2003 | Long-Term Debt Before End-User Activities | Long-Term Debt After End-User Activities | Weighted-Average (1) Contractual Interest Rate | Weighted-Average (1) Effective Rate After End-User Activities |
| --- | --- | --- | --- | --- |
| U.S. dollar obligations | | | | |
| Fixed rate | $ 19,052 | $ 305 | | |
| Floating rate | 9,934 | 34,600 | | |
| Total U.S. dollar | 28,986 | 34,905 | 4.73% | 1.71% |
| Non-U.S. dollar obligations | 14,543 | 8,624 | | |
| Total | $ 43,529 | $ 43,529 | 4.20% | 1.86% |

| IN MILLIONS NOVEMBER 30, 2002 | Long-Term Debt Before End-User Activities | Long-Term Debt After End-User Activities | Weighted-Average (1) Contractual Interest Rate | Weighted-Average (1) Effective Rate After End-User Activities |
| --- | --- | --- | --- | --- |
| U.S. dollar obligations | | | | |
| Fixed rate | $ 18,330 | $ 170 | | |
| Floating rate | 9,031 | 31,729 | | |
| Total U.S. dollar | 27,361 | 31,899 | 5.25% | 2.14% |
| Non-U.S. dollar obligations | 11,317 | 6,779 | | |
| Total | $ 38,678 | $ 38,678 | 4.73% | 2.29% |

(1) Weighted-average interest rates were calculated using non-U.S. dollar interest rates, where applicable.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In March 2002, Holdings issued $575 million of floating rate convertible notes. These notes bear an interest rate at a variable rate of three month LIBOR minus 90 basis points per annum (subject to adjustment in certain events) and mature on April 1, 2022. The notes will also bear a specified additional amount of contingent interest during any quarterly interest period following a quarterly interest period in which the average trading price of the notes is above specified levels. The notes are convertible at $96.10 per share (resulting in approximately 6 million shares), in certain circumstances, including (i) Holdings' common stock trading above $120.125 for a specified number of trading days, (ii) the trading price of the notes declining to certain levels, (iii) a significant downgrade in the ratings of the notes below a specified level, (iv) the notes being called for redemption and (v) certain other events. Holdings has the option to redeem the notes for cash on or after April 1, 2004. The holders of the notes may cause the Company to repurchase the notes at par on April 1, 2004, 2007, 2012 or 2017. The Company may elect to pay the repurchase price in cash, common stock or a combination of cash and common stock. The holders of the notes may also cause the Company to repurchase the notes for cash upon a change of control of Holdings.

As a result of the Neuberger merger, on October 31, 2003 the Company assumed all obligations under an aggregate of $166 million of zero-coupon convertible notes due May 4, 2021 issued by Neuberger in May 2001. These notes were issued at an aggregate price of $143 million, representing a yield to maturity of 0.75% per year, which is accounted for using the effective interest rate method. In November 2002, the notes were amended to add cash interest payments of 3.047% per annum of the principal amount at maturity paid semi-annually until May 4, 2004. Each $1,000 principal amount at maturity of the notes is convertible into 6.5843 shares of Holdings' common stock (approximately 1.1 million shares in total) and $131.80 in cash (approximately $21.9 million in total) (based on the merger consideration paid to holders of Neuberger common stock in the merger) in certain circumstances, including (i) Holdings' common stock trading for a specified number of trading days in any calendar quarter above a specified percentage (beginning at 120% on June 30, 2001 and declining 0.12658% each quarter thereafter) of the accreted value of the notes divided by 8.47717, (ii) a significant downgrade in the ratings of the notes below a specified level, (iii) the notes being called for redemption and (iv) certain other events. The Company may redeem the notes for cash on or after May 4, 2006, at their accreted value. The holders of the notes may cause the Company to repurchase the notes at their accreted value on May 4 of 2004, 2006, 2011 and 2016. The Company may elect to pay the repurchase price in cash, common stock or a combination of cash and common stock. The holders of the notes may also cause Holdings to repurchase the notes for cash upon a change of control of Holdings occurring on or before May 4, 2006.



## NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107 *"Disclosures about Fair Value of Financial Instruments"* requires the Company to report the fair value of financial instruments, as defined. Assets and liabilities that are carried at fair value include all of the Company's trading assets and liabilities, including derivative financial instruments used for trading purposes as described in Note 1, which are recorded as Securities and other inventory positions owned and Securities and other inventory positions sold but not yet purchased.

Assets and liabilities, recorded at contractual amounts, that approximate market or fair value include Cash and cash equivalents, Cash and securities segregated and on deposit for regulatory and other purposes, receivables, certain other assets, Commercial paper and short-term debt and payables. The market values of such items are not materially sensitive to shifts in market interest rates because of the limited term to maturity of these instruments and their variable interest rates.

The Company's long-term debt is recorded at historical amounts, unless designated as the hedged item in a fair value hedge under SFAS 133. The Company carries such hedged debt on a modified mark-to-market basis, which amount could differ from fair value as a result of changes in the Company's credit worthiness.

The following table provides a summary of the fair value of the Company's long-term debt and related End-User Derivative Activities. The fair value of the Company's long-term debt was estimated using either quoted market prices or discounted cash flow analyses based on the Company's current borrowing rates for similar types of borrowing arrangements.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

## FAIR VALUE OF LONG-TERM DEBT

| IN MILLIONS<br>NOVEMBER 30 | 2003 | 2002 |
|---|---|---|
| Carrying value of long-term debt | **$ 43,529** | $ 38,678 |
| Fair value of long-term debt | **43,961** | 38,968 |
| Unrecognized net loss on long-term debt | **$ (432)** | $ (290) |

The Company carries its secured financing activities, including Securities purchased under agreements to resell, Securities borrowed, Securities sold under agreements to repurchase, Securities loaned and Other secured borrowings, at their original contract amount plus accrued interest. Because the majority of such financing activities are short-term in nature, carrying value approximates fair value. At November 30, 2003 and 2002 the Company had $275 billion and $230 billion, respectively, of such secured financing activities. As with the Company' s long-term debt, its secured financing activities expose the Company to interest rate risk.

At November 30, 2003 and 2002 the Company, as an end user, used derivative financial instruments with an aggregate notional amount of $8.1 billion and $6.9 billion, respectively, to modify the interest rate characteristics of its secured financing activities. At November 30, 2003 and 2002 the carrying values of these secured financing activities designated as fair value hedges approximated their fair values. Additionally, at November 30, 2003 and 2002, the Company had approximately $31 million and $30 million, respectively, of unrecognized losses related to approximately $1.1 billion and $3.9 billion, respectively, of long-term fixed rate repurchase agreements.

## NOTE 11 COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into various commitments and guarantees, including lending commitments to high grade and high yield borrowers, private equity investment commitments, liquidity committments and other guarantees. In all instances, the Company marks-to-market these commitments and guarantees with changes in fair value recognized in Principal transactions revenue.

### Lending Related Commitments

In connection with its financing activities, the Company had outstanding commitments under certain collateralized lending arrangements of approximately $5.0 billion and $1.5 billion at November 30, 2003 and 2002, respectively. These commitments require borrowers to provide acceptable collateral, as defined in the agreements, when amounts are drawn under the lending facilities. Advances made under these lending arrangements are typically at variable interest rates and generally provide for over-collateralization based on the borrowers' creditworthiness. In addition, at November 30, 2003, the Company had commitments to enter into forward starting, secured resale and reverse repurchase agreements, principally secured by government and government agency collateral, of $78.4 billion and $46.2 billion, respectively, compared with $89.9 billion and $50.3 billion, respectively, at November 30, 2002.

The Company, through its high grade and high yield sales, trading and underwriting activities, makes commitments to extend credit in loan syndication transactions. The Company uses various hedging and funding strategies to actively manage its market, credit and liquidity exposures on these commitments. In addition, total commitments are not indicative of actual risk or funding requirements, as the commitments may not be drawn or fully used. These commitments and any related draw downs of these facilities typically have fixed



maturity dates and are contingent upon certain representations, warranties and contractual conditions applicable to the borrower.

The Company had credit risk associated with lending commitments to investment grade borrowers (after consideration of credit risk hedges) of $3.0 billion and $3.2 billion at November 30, 2003 and 2002, respectively. In addition, the Company had credit risk associated with

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

lending commitments to non-investment grade borrowers (after consideration of credit risk hedges) of $2.6 billion and $1.7 billion at November 30, 2003 and 2002, respectively. Before consideration of credit risk hedges, the Company had commitments to investment and non-investment grade borrowers of $8.1 billion and $2.9 billion at November 30, 2003, respectively, compared with $7.1 billion and $1.8 billion at November 30, 2002, respectively. The Company had available undrawn borrowing facilities with third parties of approximately $5.1 billion and $5.2 billion at November 30, 2003 and 2002, respectively, which can be drawn upon to provide funding for these commitments. These funding facilities contain limits for certain concentrations of counterparty, industry or credit ratings of the underlying loans.

In addition, the Company provided high yield contingent commitments related to acquisition financing of approximately $2.5 billion and $2.8 billion at November 30, 2003 and 2002, respectively. The Company' s intent is, and its past practice has been, to sell down significantly all the credit risk associated with these loans, if closed, through loan syndications consistent with the Company' s credit facilitation framework. These commitments are not indicative of the Company' s actual risk because the borrower often will raise funds in the capital markets instead of drawing on the Company' s commitment. Additionally, the borrower' s ability to draw is subject to there being no material adverse change in either market conditions or the borrower' s financial condition, among other factors. These commitments contain certain flexible pricing features to adjust for changing market conditions prior to closing.

The Company defines high yield (non-investment grade) exposures as securities of or loans to companies rated BB+ or lower or equivalent ratings by recognized credit rating agencies, as well as non-rated securities or loans that, in the opinion of management, are non-investment grade. See "Critical Accounting Policies and Estimates−High Yield" on page 63 for a discussion of the valuation of non-investment grade exposures.

At November 30, 2003 the Company had outstanding mortgage loan commitments of approximately $3.1 billion, including $2.6 billion of residential mortgages and $0.5 billion of commercial mortgages. These commitments require the Company to transact mortgage loans generally within 90 days at fixed and variable interest rates. The Company intends to sell such loans, once originated, through securitization.

Securities and other inventory positions sold but not yet purchased represent obligations of the Company to purchase the securities at prevailing market prices. Therefore, the future satisfaction of such obligations may be for an amount greater or less than the amount recorded. The ultimate gain or loss is dependent upon the price at which the underlying financial instrument is purchased to settle the Company' s obligation under the sale commitment.

In the normal course of business, the Company is exposed to credit and market risk as a result of executing, financing and settling various customer security and commodity transactions. These risks arise from the potential that customers or counterparties fail to satisfy their obligations and that the collateral obtained is insufficient. In such instances, the Company may be required to purchase or sell financial instruments at unfavorable market prices. The Company seeks to control these risks by obtaining margin balances and other collateral in accordance with regulatory and internal guidelines.

Subsidiaries of the Company, as general partner, are contingently liable for the obligations of certain public and private limited partnerships organized as pooled investment funds or engaged primarily in real estate activities. In the opinion of the Company, contingent liabilities, if any, for the obligations of such partnerships will not, in the aggregate, have a material adverse effect on the Company' s consolidated financial position or results of operations.

**Other Commitments and Guarantees**

In accordance with FASB Interpretation No. 45, *"Guarantor' s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,"* ("FIN 45"), the Company is required to recognize certain guarantee contracts at the inception of such guarantee contract at fair value. The Company has followed a long-standing policy of recording guarantees, including derivative guarantees, at fair value and, accordingly, the adoption of FIN 45 did not affect the Company' s financial position or results of operations. In accordance with FIN 45 the Company also is required to disclose certain guarantees, including derivative contracts, that require the Company to make payments to a counterparty based on changes on an underlying instrument or index (e.g., security prices, interest rates, and currency rates). Derivatives that meet the FIN 45 definition of a guarantee include credit default swaps, written put options, written foreign exchange options and written interest rate caps and floors. Under FIN 45, derivatives are not considered guarantees if such contracts are cash settled and the

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Company has no basis to determine whether it is probable the derivative counterparty held the related underlying instrument. Accordingly, if these conditions are met, the Company has not included such derivative contracts in the disclosure.

At November 30, 2003, the maximum payout value of derivative contracts deemed to meet the FIN 45 definition of a guarantee was approximately $322 billion. For purposes of determining maximum



payout, notional values were used; however, the Company believes the fair value of these contracts is a more relevant measure of these obligations. At November 30, 2003, the fair value of such derivative contracts approximated $9 billion. The Company believes the notional amounts greatly overstate the Company' s expected payout. For a discussion of the valuation of derivative contracts, see "Critical Accounting Policies and Estimates−Fair Value" on page 61. In addition, all amounts included above are before consideration of hedging transactions. These derivative contracts are generally highly liquid, and the Company has substantially mitigated its risk on these contracts through hedges, such as other derivative contracts and/or cash instruments. The Company manages risk associated with derivative guarantees consistent with the Company' s global risk management policies. The Company records derivative contracts, including those considered to be guarantees under FIN 45, at fair value with related gains/losses recognized in Principal transactions revenue.

At November 30, 2003, the Company had liquidity commitments of approximately $5.1 billion related to trust certificates backed by investment grade municipal securities compared with $4.4 billion at November 30, 2002. The Company' s obligations under such liquidity commitments generally are less than one year and are further limited because the Company' s obligations cease if the underlying assets are downgraded below investment grade or default.

At November 30, 2003 and 2002, the Company was contingently liable for $913 million and $835 million, respectively, of letters of credit primarily used to provide collateral for securities and commodities borrowed and to satisfy margin deposits at option and commodity exchanges.

At November 30, 2003 and 2002, the Company had private equity commitments of approximately $382 million and $672 million, respectively. The Company' s private equity commitment of $382 million at November 30, 2003 will be funded as required through the end of the respective investment periods. In addition, the Company was committed to invest up to $170 million in an energy-related principal investment at November 30, 2003.

In the normal course of business, the Company provides guarantees to securities clearinghouses and exchanges. These guarantees are generally required under the standard membership agreements, such that members are required to guarantee the performance of other members. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. The Company' s obligation under such guarantees could exceed the collateral amounts posted; however, the potential for the Company to be required to make payments under such guarantees is deemed remote.

In connection with certain asset sales and securitization transactions, the Company often makes representations and warranties about the assets conforming to specified guidelines. If it is later determined the underlying assets fail to conform to the specified guidelines, the Company may have an obligation to repurchase the assets or indemnify the purchaser against any losses. To mitigate these risks, to the extent the assets being securitized may have been originated by other third parties, the Company seeks to obtain appropriate representations and warranties from these third parties upon acquisition of such assets.

**Litigation**

In the normal course of business the Company has been named a defendant in a number of lawsuits and other legal and regulatory proceedings. Such proceedings include actions brought against the Company and others with respect to transactions in which the Company acted as an underwriter or financial advisor, actions arising out of the Company' s activities as a broker or dealer in securities and commodities and actions brought on behalf of various classes of claimants against many securities firms, including the Company. Although there can be no assurance as to the ultimate outcome, the Company generally has denied, or believes it has a meritorious defense and will deny, liability in all

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

significant cases pending against it, and it intends to defend vigorously each such case. After considering all relevant facts and established reserves, in the opinion of the Company, such litigation will not, in the aggregate, have a material adverse effect on the Company' s consolidated financial position or cash flows, but may be material to the Company' s operating results for any particular period, depending on the level of income for such period.

**Concentrations of Credit Risk**

As a leading global investment bank, the Company is actively involved in securities underwriting, brokerage, distribution and trading. These and other related services are provided on a worldwide basis to a large and diversified group of clients and customers, including multi-national corporations, governments, emerging growth companies, financial institutions and individual investors.

A substantial portion of the Company' s securities and commodities transactions are collateralized and are executed with, and on behalf of, commercial banks and other institutional investors, including other brokers and dealers. The Company' s exposure to credit risk associated with the non-performance of these customers and counterparties in fulfilling their contractual obligations pursuant to securities transactions can be directly impacted by volatile or illiquid trading markets, which may impair the ability of customers and counterparties to satisfy their obligations to the Company.

Securities and other inventory positions owned by the Company include U.S. government and agency securities, and securities issued by non-U.S. governments, which in the aggregate, represented 11% of the Company' s total assets at November 30, 2003. In addition, collateral held by the Company for resale agreements represented approximately 28% of total assets at November 30, 2003, and primarily consisted of securities issued by the U.S. government, federal agencies or non-U.S.



governments. The Company' s most significant industry concentration is financial institutions, which includes other brokers and dealers, commercial banks and institutional clients. This concentration arises in the normal course of the Company' s business.

**Lease Commitments**

The Company leases office space and equipment throughout the world. Total rent expense for 2003, 2002 and 2001 was $136 million, $148 million and $98 million, respectively. Certain leases on office space contain escalation clauses providing for additional payments based on maintenance, utility and tax increases.

Minimum future rental commitments under non-cancelable operating leases (net of subleases of $99 million) are as follows:

**MINIMUM FUTURE RENTAL COMMITMENTS UNDER OPERATING LEASE AGREEMENTS**

| IN MILLIONS | | |
|---|---|---|
| Fiscal 2004 | $ | 185 |
| Fiscal 2005 | | 179 |
| Fiscal 2006 | | 169 |
| Fiscal 2007 | | 161 |
| Fiscal 2008 | | 158 |
| December 1, 2008 and thereafter | | 1,314 |
| Total | $ | 2,166 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Included in the previous table are rental commitments of approximately $652 million associated with properties that have been or will be vacated resulting from the Company' s decision to exit certain of its New York City facilities (resulting from occupancy actions taken after the events of September 11th), and the consolidation of certain U.S. and foreign branches (See Note 21 for additional information regarding the September 11th and Real Estate Related Charges).

The Company entered into a lease for its new European headquarters at Canary Wharf in London. This lease qualifies for capital lease treatment under SFAS No. 13 *"Accounting for Leases."* The Company' s lease at Canary Wharf expires in September 2033.

**MINIMUM FUTURE COMMITMENTS UNDER THE CAPITAL LEASE AGREEMENT**

| IN MILLIONS | | |
|---|---|---|
| Fiscal 2004 | $ | – |
| Fiscal 2005 | | 53 |
| Fiscal 2006 | | 54 |
| Fiscal 2007 | | 54 |
| Fiscal 2008 | | 54 |
| December 1, 2008 and thereafter | | 2,446 |
| Total minimum lease payments | | 2,661 |
| Less: Amounts of these payments that represent interest | | 1,681 |
| Present value of future minimum capital lease payments | $ | 980 |

**NOTE 12 PREFERRED SECURITIES SUBJECT TO MANDATORY REDEMPTION**

At November 30, 2003, the Company owned the residual equity of four Delaware business trusts that had issued an aggregate liquidation value of $1,310 million of capital securities. The trusts were formed for the purpose of: (a) issuing trust securities representing ownership interests in the assets of the trust; (b) investing the gross proceeds of the trust securities in junior subordinated debentures of the Company; and (c) engaging in activities necessary or incidental thereto. Loans from the trusts to the Company represented by the junior subordinated debentures are eliminated in consolidation. Dividends on the trust preferred securities are presented on a basis consistent with minority interest in the income of subsidiaries and are shown as a reduction to the Company' s income from continuing operations, net of tax. Preferred securities subject to mandatory redemption are comprised of the following issues:

| IN MILLIONS<br>NOVEMBER 30 | | 2003 | | 2002 |
|---|---|---|---|---|
| Lehman Brothers Holdings Capital Trust I | **$** | **325** | $ | 325 |
| Lehman Brothers Holdings Capital Trust II | | **385** | | 385 |
| Lehman Brothers Holdings Capital Trust III | | **300** | | – |
| Lehman Brothers Holdings Capital Trust IV | | **300** | | – |
| Total | **$** | **1,310** | $ | 710 |



The following table summarizes the financial structure of each such trust at November 30, 2003:

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | Holdings Capital Trust I | Holdings Capital Trust II | Holdings Capital Trust III | Holdings Capital Trust IV |
|---|---|---|---|---|
| **TRUST SECURITIES** | | | | |
| Issuance date | January 1999 | April 1999 | March 2003 | October 2003 |
| Preferred securities issued | 13,000,000 Series I | 15,400,000 Series J | 12,000,000 Series K | 12,000,000 Series L |
| Liquidation preference per security | $ 25 | $ 25 | $ 25 | $ 25 |
| Liquidation value (in millions) | $ 325 | $ 385 | $ 300 | $ 300 |
| Coupon rate | 8% | 7.88% | 6.38% | 6.38% |
| Distributions payable | Quarterly | Quarterly | Quarterly | Quarterly |
| Distributions guaranteed by | Holdings | Holdings | Holdings | Holdings |
| Mandatory redemption date | March 31, 2048 | June 30, 2048 | March 15, 2052 | October 31, 2052 |
| Redeemable by issuer on or after | March 31, 2004 | June 30, 2004 | March 15, 2008 | October 31, 2008 |
| | | | | |
| **JUNIOR SUBORDINATED DEBENTURES** | | | | |
| Principal amount outstanding (in millions) | $ 325 | $ 385 | $ 300 | $ 300 |
| Coupon rate | 8% | 7.88% | 6.38% | 6.38% |
| Interest payable | Quarterly | Quarterly | Quarterly | Quarterly |
| Maturity date | March 31, 2048 | June 30, 2048 | March 15, 2052 | October 31, 2052 |
| Redeemable by issuer on or after | March 31, 2004 | June 30, 2004 | March 15, 2008 | October 31, 2008 |

The Company anticipates de-consolidating the trusts that issue Preferred securities subject to mandatory redemption upon adoption of FIN 46, effective as of February 29, 2004. The de-consolidation will have the effect of reclassifying such preferred securities subject to mandatory redemption out of the mezzanine classification of the Company' s Consolidated Statement of Financial Condition and into Long-Term Debt. Likewise, the Company will reclassify, on a prospective basis, the pretax amount of dividends on such preferred securities to Interest expense in the Company' s results of operations.

## NOTE 13 PREFERRED STOCK

Holdings is authorized to issue a total of 38,000,000 shares of preferred stock. At November 30, 2003, Holdings had 728,000 shares issued and outstanding under various series as described below. All preferred stock has a dividend preference over Holdings' common stock in the paying of dividends and a preference in the liquidation of assets.

### Series C

On May 11, 1998, Holdings issued 5,000,000 Depositary Shares, each representing 1/10th of a share of 5.94% Cumulative Preferred Stock, Series C ("Series C Preferred Stock"), $1.00 par value. The shares of Series C Preferred Stock have a redemption price of $500 per share, together with accrued and unpaid dividends. Holdings may redeem any or all of the outstanding shares of Series C Preferred Stock beginning on May 31, 2008. The $250 million redemption value of the shares outstanding at November 30, 2003 is classified in the Consolidated Statement of Financial Condition as a component of Preferred stock.

### Series D

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

On July 21, 1998, Holdings issued 4,000,000 Depositary Shares, each representing 1/100th of a share of 5.67% Cumulative Preferred Stock, Series D ("Series D Preferred Stock"), $1.00 par value. The shares of Series D Preferred Stock have a redemption price of $5,000 per share, together with accrued and unpaid dividends. Holdings may redeem any or all of the outstanding shares of Series D Preferred Stock beginning on August 31, 2008. The $200 million redemption value of the shares outstanding at November 30, 2003 is classified in the Consolidated Statement of Financial Condition as a component of Preferred stock.

**Series E**

On March 28, 2000, Holdings issued 5,000,000 Depositary Shares, each representing 1/100th of a share of Fixed/Adjustable Rate Cumulative Preferred Stock, Series E ("Series E Preferred Stock"), $1.00 par value. The initial cumulative dividend rate on the Series E Preferred Stock is



7.115% per annum through May 31, 2005; thereafter the rate will be the higher of either the three-month U.S. Treasury Bill rate, the 10-year Treasury constant maturity rate or the 30-year U.S. Treasury constant maturity rate, in each case plus 1.15%, but in any event not less than 7.615% nor greater than 13.615%. The shares of Series E Preferred Stock have a redemption price of $5,000 per share, together with accrued and unpaid dividends. Holdings may redeem any or all of the outstanding shares of Series E Preferred Stock beginning on May 31, 2005. The $250 million redemption value of the shares outstanding at November 30, 2003 is classified in the Consolidated Statement of Financial Condition as a component of Preferred stock.

**Series F**

On August 20, 2003, Holdings issued 13,800,000 Depositary Shares, each representing 1/100th of a share of 6.50% Cumulative Preferred Stock, Series F ("Series F Preferred Stock"), $1.00 par value. The shares of Series F Preferred Stock have a redemption price of $2,500 per share, together with accrued and unpaid dividends. Holdings may redeem any or all of the outstanding shares of Series F Preferred Stock beginning on August 31, 2008. The $345 million redemption value of the shares outstanding at November 30, 2003 is classified in the Consolidated Statement of Financial Condition as a component of Preferred stock.

The Series C, D, E and F Preferred Stock has no voting rights except as provided below or as otherwise from time to time required by law. If dividends payable on any of the Series C, D, E or F Preferred Stock or on any other equally-ranked series of preferred stock have not been paid for six or more quarters, whether or not consecutive, the authorized number of directors of the Company will automatically be increased by two. The holders of the Series C, D, E or F Preferred Stock will have the right, with holders of any other equally-ranked series of preferred stock that have similar voting rights and on which dividends likewise have not been paid, voting together as a class, to elect two directors to fill such newly-created directorships until the dividends in arrears are paid.

**Redeemable Voting**

In 1994, Holdings issued the Redeemable Voting Preferred Stock to American Express and Nippon Life for $1,000. The holders of the Redeemable Voting Preferred Stock were entitled to receive annual dividends through May 31, 2002, in an amount equal to 50% of the amount, if any, by which the Company' s net income for each year exceeded $400 million, up to a maximum of $50 million per year ($25 million on a pro-rated basis, for the last dividend period, which ran from December 1, 2001 to May 31, 2002). For the years ended November 30, 2002 and 2001, the Company' s net income resulted in the recognition of dividends in those years in the amounts of $25 million and $50 million respectively, on the Redeemable Voting Preferred Stock. On the final dividend payment date, July 15, 2002, Holdings redeemed all of the Redeemable Preferred Stock, for a total of $1,000.

**NOTE 14 COMMON STOCK**

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

In April 2001, the Company' s shareholders approved the adoption of an amendment of the Company' s Restated Certificate of Incorporation to increase the aggregate number of authorized shares of common stock from 300 million to 600 million.

During the years ended November 30, 2003, 2002 and 2001, the Company repurchased or acquired shares of its common stock at an aggregate cost of approximately $1,508 million, $1,510 million and $1,676 million, respectively. These shares were acquired in the open market and from employees who tendered mature shares to pay for the exercise cost of stock options or for statutory tax withholding obligations on RSU issuances or option exercises.

Changes in the number of shares of Holdings' common stock outstanding are as follows:

**COMMON STOCK**

| NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| Shares outstanding, beginning of period | **231,131,043** | 237,534,091 | 236,395,332 |
| Exercise of stock options and other share issuances | **11,538,125** | 10,455,954 | 8,369,721 |
| Issuances of shares to the RSU Trust | **14,000,000** | 9,300,000 | 16,000,000 |
| Shares issued in connection with the Neuberger acquisition | **33,130,804** | – | – |
| Treasury stock purchases | **(23,120,916)** | (26,159,002) | (23,230,962) |
| Shares outstanding, end of period | **266,679,056** | 231,131,043 | 237,534,091 |



In 1997, the Company established an irrevocable grantor trust (the "RSU Trust") to provide common stock voting rights to employees who hold outstanding restricted stock units ("RSUs") and to encourage employees to think and act like owners. In 2003, 2002 and 2001, 14.0 million, 9.3 million and 16.0 million treasury shares, respectively, were transferred into the RSU Trust. At November 30, 2003, approximately 33.4 million shares were held in the RSU Trust with a total value of approximately $851 million. For accounting purposes, these shares are valued at weighted-average grant prices. Shares transferred to the RSU Trust do not affect the total number of shares used in the computation of earnings per common share because the Company considers the RSUs to be common stock equivalents for purposes of this computation. Accordingly, the RSU Trust has no effect on the total equity, net income or earnings per share of the Company.

In connection with the Neuberger acquisition, the Company issued 32,326,000 shares of common stock to acquire Neuberger and 804,804 shares of restricted common stock, a portion of which is subject to future service requirements.

## NOTE 15 INCENTIVE PLANS

### Employee Stock Purchase Plan

The Employee Stock Purchase Plan (the "ESPP") allows employees to purchase Common Stock at a 15% discount from market value, with a maximum of $25,000 in annual aggregate purchases by any one individual. The number of shares of Common Stock authorized for purchase by eligible employees is 12.0 million. At November 30, 2003 and 2002, 6.1 million shares and 5.8 million shares, respectively, of Common Stock had cumulatively been purchased by eligible employees through the ESPP.

### 1994 Management Ownership Plan

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Lehman Brothers Holdings Inc. 1994 Management Ownership Plan (the "1994 Plan") provides for the issuance of RSUs, performance stock units ("PSUs"), stock options and other equity awards for a period of up to ten years to eligible employees. A total of 33.3 million shares of Common Stock may be granted under the 1994 Plan. At November 30, 2003, RSU, PSU and stock option awards with respect to 31.2 million shares of Common Stock have been made under the 1994 Plan, of which 1.5 million are outstanding and 29.7 million have been converted to freely transferable Common Stock.

**1996 Management Ownership Plan**

During 1996, the Company' s stockholders approved the 1996 Management Ownership Plan (the "1996 Plan") under which awards similar to those of the 1994 Plan may be granted, and under which up to 42.0 million shares of Common Stock may be subject to awards. At November 30, 2003, RSU, PSU and stock option awards with respect to 38.1 million shares of Common Stock have been made under the 1996 Plan of which 18.7 million are outstanding and 19.4 million have been converted to freely transferable Common Stock.

**Employee Incentive Plan**

The Employee Incentive Plan ("EIP") has provisions similar to the 1994 Plan and the 1996 Plan, and authorization from the Board of Directors for the issuance of up to 246.0 million shares of Common Stock that may be subject to awards. At November 30, 2003 awards with respect to 204.5 million shares of Common Stock have been made under the EIP of which 125.3 million are outstanding and 79.2 million have been converted to freely transferable Common Stock.

The following is a summary of RSUs outstanding under Holdings' stock-based incentive plans:

**RESTRICTED STOCK UNITS**

| | Total |
|---|---|
| **BALANCE, NOVEMBER 30, 2000** | 82,622,541 |
| Granted | 15,292,447 |
| Canceled | (3,268,825) |
| Exchanged for stock without restrictions | (18,189,092) |
| **BALANCE, NOVEMBER 30, 2001** | 76,457,071 |
| Granted | 9,178,667 |
| Canceled | (1,750,479) |
| Exchanged for stock without restrictions | (14,547,191) |
| **BALANCE, NOVEMBER 30, 2002** | 69,338,068 |
| Granted | 13,071,646 |
| Canceled | (1,447,319) |
| Exchanged for stock without restrictions | (18,344,208) |
| **BALANCE, NOVEMBER 30, 2003 (1)** | 62,618,187 |

(1) Excludes RSUs issued in connection with the Company' s acquisition of Neuberger. See Neuberger Acquisition on page 97 and Note 6 to the Consolidated Financial Statements.

Eligible employees receive RSUs as a portion of their total compensation in lieu of cash. There is no further cost to employees associated with the RSU awards. The Company measures compensation cost for RSUs based on the market value of its Common Stock at the grant date and amortizes this amount to expense over the applicable vesting periods. RSU awards made to employees have various vesting provisions and generally convert to unrestricted freely transferable Common Stock five years from the grant date. Holdings accrues a dividend equivalent on each RSU outstanding (in the form of additional RSUs), based on dividends declared on its Common Stock.



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company has repurchased approximately 41.3 million shares to offset the future delivery requirements associated with the above RSUs. These shares have either been transferred to the RSU Trust or are held as Treasury stock. (For additional information see Note 14 to the Consolidated Financial Statements.)

In 2003, the Company delivered 14.3 million shares of its Common Stock to current and former employees in satisfaction of RSUs awarded in 1998. Substantially all of the shares delivered were funded from the RSU Trust. The Company also received 4.9 million shares from current and former employees in satisfaction of applicable tax withholding requirements. Shares received were recorded as Treasury stock at an aggregate value of $354 million.

Of the RSUs outstanding at November 30, 2003, approximately 40.9 million RSUs were amortized, approximately 8.7 million RSUs will be amortized during 2004, and the remaining RSUs will be amortized subsequent to November 30, 2004.

Included in the previous table are PSUs the Company has awarded to certain senior officers. The number of PSUs that may be earned is dependent upon the achievement of certain performance levels within predetermined performance periods. During the performance period, these PSUs are accounted for as variable awards. At the end of a performance period, any PSUs earned will convert one-for-one to RSUs that then vest in three or more years. At November 30, 2003, approximately 11.1 million PSUs had been awarded, of which 6.3 million remained outstanding, subject to vesting and transfer restrictions. The compensation cost for the RSUs payable in satisfaction of PSUs is accrued over the combined performance and vesting periods.

Total compensation cost recognized during 2003, 2002 and 2001 for the Company' s stock-based awards was approximately $625 million, $570 million and $544 million, respectively.

## STOCK OPTIONS

| | Total | Weighted-Average Exercise Price | Expiration Dates |
|---|---|---|---|
| **BALANCE, NOVEMBER 30, 2000** | 54,567,639 | $ 28.62 | 2/01 - 11/10 |
| Granted | 21,529,844 | $ 53.28 | |
| Exercised | (6,261,030) | $ 16.49 | |
| Canceled | (1,442,239) | $ 27.01 | |
| **BALANCE, NOVEMBER 30, 2001** | 68,394,214 | $ 37.53 | 1/02 - 11/11 |
| Granted | 26,211,500 | $ 54.94 | |
| Exercised | (9,652,041) | $ 25.02 | |
| Canceled | (1,413,181) | $ 43.20 | |
| **BALANCE, NOVEMBER 30, 2002** | 83,540,492 | $ 44.21 | 11/03 - 11/12 |
| Granted | 11,262,532 | $ 68.74 | |
| Exercised | (10,252,890) | $ 27.85 | |
| Canceled | (1,673,376) | $ 45.57 | |
| **BALANCE, NOVEMBER 30, 2003 (1)** | 82,876,758 | $ 49.54 | 12/03 - 11/13 |

(1) Excludes stock options issued in connection with the Company' s acquisition of Neuberger (see Neuberger Acquisition on page 97 and Note 6 to the Consolidated Financial Statements).

At November 30, 2003 and 2002, approximately 18.4 million and 13.0 million stock options, respectively, were exercisable at weighted-average prices of $36.32 and $29.95, respectively. The weighted-average remaining contractual life of the stock options outstanding at November 30, 2003 is 6.3 years. The exercise price for all stock options awarded has been equal to the market price of Common Stock on the day of grant.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The above table provides further details relating to Holdings' stock options outstanding at November 30, 2003.



**STOCK OPTIONS (1)**

| | Options Outstanding | | | Options Exercisable | | |
|---|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (in years) | Number Exercisable | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (in years) |
| $ 9.00 - $ 9.99 | 280,000 | $ 9.00 | 0.50 | 280,000 | $ 9.00 | 0.50 |
| $ 10.00 - $19.99 | 27,308 | $ 19.88 | 1.00 | 27,308 | $ 19.88 | 1.00 |
| $ 20.00 - $29.99 | 8,834,257 | $ 22.91 | 3.22 | 5,867,574 | $ 21.43 | 4.31 |
| $ 30.00 - $39.99 | 12,412,560 | $ 33.67 | 2.58 | 6,041,505 | $ 33.19 | 1.77 |
| $ 40.00 - $49.99 | 13,101,707 | $ 47.86 | 6.72 | 3,066,008 | $ 48.85 | 5.54 |
| $ 50.00 - $59.99 | 28,832,600 | $ 53.79 | 7.43 | 821,168 | $ 54.58 | 4.99 |
| $ 60.00 - $69.99 | 9,917,236 | $ 63.39 | 6.48 | 2,250,785 | $ 63.40 | 6.32 |
| $ 70.00 - $79.99 | 9,471,090 | $ 71.39 | 10.00 | – | – | – |
| **BALANCE, NOVEMBER 30, 2003** | **82,876,758** | **$ 49.54** | **6.29** | **18,354,348** | **$ 36.32** | **3.89** |

(1) Excludes stock options issued in connection with the Company' s acquisition of Neuberger (see Neuberger Acquisition below and Note 6 to the Consolidated Financial Statements).

**Neuberger Acquisition**

In connection with the Company' s acquisition of Neuberger, the Company assumed the obligations of Neuberger under the following plans:

**1999 Long Term Incentive Plan**

The Neuberger 1999 Long Term Incentive Plan (the "LTIP") provides for the grant of restricted stock, restricted units, incentive stock, incentive units, deferred shares, supplemental units and stock options. Upon the Company' s acquisition of Neuberger, the Company issued approximately 648,000 shares of restricted common stock to replace existing restricted stock awards, of which 225,000 shares with an approximate value of $14 million were vested and included in the acquisition price and 423,000 shares with an approximate value of $35 million were subject to future service and will be amortized over the applicable service periods. In addition, all outstanding stock option awards under the LTIP became 100% vested and non-forfeitable and were converted into 3.4 million stock option awards relating to the Company' s Common Stock.

The Company also issued 800,000 stock options under the plan with an exercise price of $72 that vest ratably over five years and expire in October 2008. The Company also issued approximately 1.7 million RSUs valued at approximately $118.7 million that vest ratably over five years.

The total number of shares of Common Stock that may be issued under the LTIP may not exceed approximately 7.7 million. At November 30, 2003 restricted stock, RSUs and stock options relating to 6.6 million shares of Common Stock were outstanding under the LTIP, and 1.1 million shares of Common Stock were available for issuance.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

### 1999 Directors Stock Incentive Plan

The Neuberger 1999 Directors Stock Incentive Plan (the "DSIP") provided for the grant of stock options or restricted stock to non-employee members of Neuberger' s board of directors. Non-employee directors could elect to exchange a portion of their annual cash retainer paid by Neuberger for services rendered as a director for restricted stock. Upon the Company' s acquisition of Neuberger, all outstanding stock option awards under the DSIP became 100% vested and non-forfeitable and were converted into approximately 62,000 stock option awards on shares of the Company' s Common Stock, all of which were outstanding at November 30, 2003. The Company does not intend to grant additional awards from the DSIP.

### Wealth Accumulation Plan

The Neuberger Wealth Accumulation Plan (the "WAP") provides that on an annual basis, employees who are eligible for a bonus may elect to defer all or a portion of their bonus, and employees who receive commissions and other direct pay may elect to defer a portion of such compensation. In each case, up to 20% of total compensation may be deferred with a maximum deferral of up to $500,000, provided that employees who receive an annual bonus may, in any event, defer no more than the full amount of the bonus. Amounts deferred by employees are used to acquire, on a pretax basis, the stock at a 25% discount from market value. Any stock so acquired is restricted with respect to transfer or sale and vests three years after the grant date.



Certain benefits of ownership, including the payment of any dividends declared during the restricted period, belong to the employees. Upon the Company' s acquisition of Neuberger, all shares of Neuberger stock previously acquired under the WAP were converted into approximately 157,000 shares of the Company' s Common Stock, of which 90,000 shares with an approximate value of $6 million were vested and included in the acquisition price and 67,000 shares with an approximate value of $7 million were subject to future service and will be amortized over the applicable service periods. The Company does not intend to allow any further deferrals under the WAP and has provided that the WAP will terminate on the last day on which any restricted stock outstanding under the WAP becomes vested.

## NOTE 16 EARNINGS PER COMMON SHARE

Earnings per share was calculated as follows:

### EARNINGS PER COMMON SHARE

| IN MILLIONS, EXCEPT FOR PER SHARE DATA<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **NUMERATOR:** | | | |
| Net income | **$ 1,699** | $ 975 | $ 1,255 |
| Preferred stock dividends | **50** | 69 | 94 |
| Numerator for basic earnings per share–net income applicable to common stock | **$ 1,649** | $ 906 | $ 1,161 |
| **DENOMINATOR:** | | | |
| Denominator for basic earnings per share– weighted-average common shares | | | |
| Effect of dilutive securities: | | | |
| Employee stock options | **12.2** | 12.4 | 16.2 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | |
|---|---|---|---|
| Restricted stock units | **2.0** | 3.4 | 6.0 |
| Dilutive potential common shares | **14.2** | 15.8 | 22.2 |
| Denominator for diluted earnings per share−weighted-average common and dilutive potential common shares | **259.9** | 261.2 | 265.3 |
| **BASIC EARNINGS PER SHARE** | **$ 6.71** | $ 3.69 | $ 4.77 |
| **DILUTED EARNINGS PER SHARE** | **$ 6.35** | $ 3.47 | $ 4.38 |

## NOTE 17 CAPITAL REQUIREMENTS

The Company operates globally through a network of subsidiaries, with several subject to regulatory requirements. In the United States, LBI and Neuberger Berman, LLC (“NBLLC”), as registered broker-dealers, are subject to the Securities and Exchange Commission (“SEC”) Rule 15c3-1, the Net Capital Rule, which requires these companies to maintain net capital of not less than the greater of 2% of aggregate debit items arising from customer transactions, as defined, or 4% of funds required to be segregated for customers’ regulated commodity accounts, as defined. At November 30, 2003, LBI and NBLLC had regulatory net capital, as defined, of $2,033 million and $320 million, respectively, which exceeded the minimum requirement by $1,853 million and $301 million, respectively.

Lehman Brothers International (Europe) (“LBIE”), a United Kingdom registered broker-dealer and subsidiary of Holdings, is subject to the capital requirements of the Financial Services Authority (“FSA”) of the United Kingdom. Financial resources, as defined, must exceed



the total financial resources requirement of the FSA. At November 30, 2003, LBIE’ s financial resources of approximately $2,950 million exceeded the minimum requirement by approximately $907 million. Lehman Brothers Japan Inc.’ s Tokyo branch, a regulated broker-dealer, is subject to the capital requirements of the Financial Services Agency and, at November 30, 2003, had net capital of approximately $534 million, which was approximately $247 million in excess of the specified levels required. Lehman Brothers Bank, FSB (the “Bank”), the Company’ s thrift subsidiary, is regulated by the Office of Thrift Supervision (“OTS”). The Bank exceeds all regulatory capital requirements and is considered well capitalized by the OTS. Certain other non-U.S. subsidiaries are subject to various securities, commodities and banking regulations and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. At November 30, 2003, these other subsidiaries were in compliance with their applicable local capital adequacy requirements. In addition, the Company’ s “AAA” rated derivatives subsidiaries, Lehman Brothers Financial Products Inc. (“LBFP”) and Lehman Brothers Derivative Products Inc. (“LBDP”), have established certain capital and operating restrictions that are reviewed by various rating agencies. At November 30, 2003, LBFP and LBDP each had capital that exceeded the requirements of the rating agencies.

The regulatory rules referred to above, and certain covenants contained in various debt agreements, may restrict Holdings’ ability to withdraw capital from its regulated subsidiaries, which in turn could limit its ability to pay dividends to shareholders. At November 30, 2003, approximately $5.8 billion of net assets of subsidiaries were restricted as to the payment of dividends to Holdings.

## NOTE 18 EMPLOYEE BENEFIT PLANS

The Company provides various pension plans for the majority of its employees worldwide. In addition, the Company provides certain other postretirement benefits, primarily health care and life insurance, to eligible employees. The following summarizes these plans:

### DEFINED BENEFIT PLANS

| | **Pension Benefits** | | | | | |
|---|---|---|---|---|---|---|
| **IN MILLIONS** | **U.S.** | | **Non-U.S.** | | **Postretirement Benefits** | |
| **NOVEMBER 30** | **2003** | **2002** | **2003** | **2002** | **2003** | **2002** |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | | |
|---|---|---|---|---|---|---|
| **CHANGE IN BENEFIT OBLIGATION** | | | | | | |
| Benefit obligation at beginning of year | **$ 669** | $ 575 | **$ 248** | $ 201 | **$ 68** | $ 53 |
| Service cost | **20** | 16 | **7** | 7 | **2** | 1 |
| Interest cost | **44** | 42 | **15** | 12 | **5** | 4 |
| Plan amendment | **5** | – | – | – | – | – |
| Actuarial (gain)/loss | **104** | 58 | **(13)** | 14 | **8** | 15 |
| Benefits paid | **(23)** | (22) | **(5)** | (5) | **(6)** | (5) |
| Foreign currency exchange rate changes | – | – | **26** | 19 | – | – |
| Projected benefit obligation at end of year | **$ 819** | $ 669 | **$ 278** | $ 248 | **$ 77** | $ 68 |
| **CHANGE IN PLAN ASSETS** | | | | | | |
| Fair value of plan assets at beginning of year | **$ 629** | $ 653 | **$ 238** | $ 150 | | |
| Actual return (loss) on plan assets, net of expenses | **70** | (82) | **31** | (18) | | |
| Employer contribution | **150** | 80 | **4** | 97 | | |
| Benefits paid | **(24)** | (22) | **(5)** | (5) | | |
| Foreign currency exchange rate changes | – | – | **26** | 14 | | |
| Fair value of plan assets at end of year | **$ 825** | $ 629 | **$ 294** | $ 238 | | |
| **FUNDED (UNDERFUNDED) STATUS** | **$ 6** | $ (40) | **$ 16** | $ (10) | **$ (77)** | $ (68) |
| Unrecognized net actuarial loss (gain) | **450** | 392 | **98** | 120 | **5** | (3) |
| Unrecognized prior service cost (credit) | **20** | 16 | **2** | 2 | **(3)** | (4) |
| Prepaid (accrued) benefit cost | **$ 476** | $ 368 | **$ 116** | $ 112 | **$ (75)** | $ (75) |
| **WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT OBLIGATION ON NOVEMBER 30** | | | | | | |
| Discount rate | **6.15%** | 6.75% | **5.57%** | 5.60% | **6.15%** | 6.75% |
| Rate of compensation increase | **4.90%** | 4.90% | **4.31%** | 3.82% | **5.00%** | 5.00% |
| Accumulated benefit obligation | **$ 782** | $ 637 | | | | |



## COMPONENTS OF NET PERIODIC COST/(BENEFIT)

| U.S. PENSIONS<br>IN MILLIONS | Pension Benefits | | | Postretirement Benefits | | |
|---|---|---|---|---|---|---|
| YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | | |
|---|---|---|---|---|---|---|
| Service cost | **$ 21** | $ 17 | $ 12 | **$ 2** | $ 1 | $ 1 |
| Interest cost | **44** | 42 | 38 | **5** | 4 | 3 |
| Expected return on plan assets | **(52)** | (58) | (82) | – | – | – |
| Recognized net actuarial loss (gain) | **27** | 12 | – | **(1)** | (1) | (1) |
| Recognized prior service cost | **2** | 1 | – | – | – | – |
| Net periodic cost (benefit) | **$ 42** | $ 14 | $ (32) | **$ 6** | $ 4 | $ 3 |
| **WEIGHTED-AVERAGE ASSUMPTIONS** | | | | | | |
| Discount rate | **6.75%** | 7.25% | 7.75% | **6.75%** | 7.25% | 7.75% |
| Expected return on plan assets | **8.50%** | 9.00% | 11.25% | – | – | – |
| Rate of compensation increase | **4.90%** | 5.00% | 5.00% | – | – | – |

**NON-U.S. PENSIONS**

| IN MILLIONS | Pension Benefits | | |
|---|---|---|---|
| YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
| Service cost | **$ 7** | $ 7 | $ 3 |
| Interest cost | **15** | 12 | 11 |
| Expected long-term return on plan assets | **(21)** | (14) | (15) |
| Recognized net actuarial loss | – | 6 | – |
| Recognized prior service cost | **2** | 1 | 1 |
| Net periodic cost | **$ 3** | $ 12 | $ – |

**Return on U.S. Plan Assets**

Establishing the expected rate of return on pension assets requires judgment. The Company considers the following factors in determining this assumption:

The types of investment classes in which pension plan assets are invested and the expected compounded return the Company can reasonably expect the portfolio to earn over appropriate time periods. The expected return reflects forward-looking economic assumptions.

The investment returns the Company can reasonably expect its active investment management program to achieve in excess of the returns expected if investments were made strictly in indexed funds.

Investment related expenses.

The Company reviews the expected long-term rate of return annually and revises it as appropriate. Also, the Company periodically commissions detailed asset/liability studies to be performed by third party professional investment advisors and actuaries. These studies project stated future returns on Plan assets. The studies performed in the past support the reasonableness of the Company’ s 8.50% assumption based on the target allocation investment classes and market conditions at the time the assumptions were established.

**U.S. Plan Assets**

The U.S. pension plan’ s assets are invested with the objective of meeting current and future benefit payment needs, while minimizing future contributions. Plan assets are invested with several investment managers. Assets are diversified among U.S. equities securities, U.S. fixed income securities, real estate and cash. The plan employs a mix of active and passive investment management programs. The strategic target of Plan asset allocation is approximately 65% U.S. equities and 35% U.S. fixed income. The allocation of Plan assets is moving toward the

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

strategic target allocation on an orderly and gradual basis. The investment sub-committee of the Company' s pension committee reviews the asset allocation quarterly and, with the approval of the pension committee determines when and how to rebalance the portfolio. The cash positions at November 30, 2003 and 2002 are higher than normal due to significant contributions near year end that were subsequently invested in both equity and fixed income categories in December 2003 and 2002, respectively. The Plan does not have a dedicated allocation to Lehman Brothers common stock, although the Plan may hold a minimal investment in Lehman Brothers common stock as a result of investment decisions made by various investment managers.



Weighted-average plan asset allocations at year end were as follows:

| | U.S. Plan Assets | |
|---|---|---|
| **NOVEMBER 30** | **2003** | **2002** |
| **U.S. PENSION** | | |
| Equity securities | **53%** | 61% |
| Fixed income securities | **23** | 21 |
| Real estate | **2** | 3 |
| Cash | **22** | 15 |
| Totals | **100%** | 100% |

The Company does not expect it to be necessary to contribute to its pension plans in 2004.

**Estimated Future U.S. Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

**BENEFIT PAYMENTS**

| IN MILLIONS<br>NOVEMBER 30 | Pension Benefit | Postretirement |
|---|---|---|
| 2004 | $ 24 | $ 4 |
| 2005 | 26 | 4 |
| 2006 | 29 | 5 |
| 2007 | 31 | 5 |
| 2008 | 34 | 5 |
| 2009 - 2013 | 217 | 22 |

**Post Retirement Benefits**

For measurement purposes, the annual health care cost trend rate was assumed to be 11% for the year ending November 30, 2004. The rate was assumed to decrease 1% per year, until it reaches 5%, and remain at that level thereafter.

Assumed health care cost trend rates have an effect on the amount reported for postretirement benefits. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| IN MILLIONS | 1% Point Increase | 1% Point Decrease |
|---|---|---|
| Effect on total service and interest cost components in 2003 | $ 0.3 | $ (0.3) |
| Effect on postretirement benefit obligation at November 30, 2003 | $ 4.1 | $ (3.9) |

## NOTE 19 INCOME TAXES

The Company files a consolidated U.S. federal income tax return reflecting the income of Holdings and its subsidiaries. The provision for income taxes consists of the following:

### INCOME TAX PROVISION

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **CURRENT** | | | |
| Federal | **$ 410** | $ 371 | $ 491 |
| State | **153** | 208 | 148 |
| Foreign | **368** | 459 | 441 |
| | **931** | 1,038 | 1,080 |
| **DEFERRED** | | | |
| Federal | **64** | (462) | (406) |
| State | **(44)** | (166) | (65) |
| Foreign | **(186)** | (42) | (172) |
| | **(166)** | (670) | (643) |
| Provision for income taxes | **$ 765** | $ 368 | $ 437 |

Income before taxes included $652 million, $406 million and $(50) million that also was subject to income taxes of foreign jurisdictions for 2003, 2002 and 2001, respectively.

The income tax provision differs from that computed by using the statutory federal income tax rate for the reasons shown below:

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| Federal income taxes at statutory rate | **$ 888** | $ 490 | $ 612 |
| State and local taxes | **71** | 27 | 54 |
| Tax-exempt income | **(122)** | (180) | (176) |
| Amortization of goodwill | **–** | – | 2 |
| Foreign operations | **(50)** | – | (55) |
| Other, net | **(22)** | 31 | – |
| Provision for income taxes | **$ 765** | $ 368 | $ 437 |

The provision for income taxes resulted in effective tax rates of 30.2%, 26.3%, and 25.0% for 2003, 2002, and 2001, respectively. The increase in the Company' s effective tax rate in 2003 from 2002 was primarily due to a higher level of pre-tax income, which reduced the impact of permanent differences, including a decrease in tax-exempt income, partially offset by an increase in tax benefits from foreign

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

operations. The increase in the effective tax rate in 2002 from 2001 was primarily due to a less favorable mix of geographic earnings, which is partially offset by a greater impact of permanent differences, including tax-exempt income.



Income tax benefits of approximately $543 million, $347 million and $549 million were allocated to Additional paid-in capital related to various employee compensation plans for 2003, 2002 and 2001. In addition, the Company recorded $(1) million of tax (benefits)/provisions from the translation of foreign currencies, which was recorded directly in Accumulated other comprehensive income, for the years 2003, 2002 and 2001, respectively.

The Company permanently reinvested its earnings in certain foreign subsidiaries. At November 30, 2003, $367 million of the Company' s accumulated earnings were permanently reinvested. At current tax rates, additional federal income taxes (net of available tax credits) of $120 million would become payable if such income were to be repatriated.

Deferred income taxes are provided for the differences between the tax bases of assets and liabilities and their reported amounts in the Consolidated Financial Statements. These temporary differences will result in future income or deductions for income tax purposes and are measured using the enacted tax rates that will be in effect when such items are expected to reverse. The Company provides for deferred income taxes on undistributed earnings of foreign subsidiaries that are not permanently reinvested.

The net deferred tax assets are included in Other assets in the accompanying Consolidated Statement of Financial Condition.

At November 30, 2003 and 2002 the deferred tax assets and liabilities consisted of the following:

**Deferred Tax Assets and Liabilities**

| **IN MILLIONS**<br>**NOVEMBER 30** | **2003** | **2002** |
|---|---|---|
| Deferred Tax Assets: | | |
| Liabilities/accruals not currently deductible | **$ 838** | $ 698 |
| Deferred compensation | **1,032** | 898 |
| Unrealized trading activity | **463** | 336 |
| Foreign tax credits including carryforwards | **212** | 284 |
| Net operating loss carryforwards | **88** | 53 |
| Other | **204** | 214 |
| Total deferred tax assets | **2,837** | 2,483 |
| Less: Valuation allowance | **(25)** | (25) |
| Total deferred tax assets, net of valuation allowance | **$ 2,812** | $ 2,458 |
| | | |
| Deferred Tax Liabilities: | | |
| Excess tax over financial depreciation, net | **$ (18)** | $ 2 |
| Acquired intangibles | **(420)** | – |
| Pension and retirement costs | **(172)** | (128) |
| Other | **(32)** | (7) |
| Total deferred tax liabilities | **(642)** | (133) |
| Net deferred tax assets | **$ 2,170** | $ 2,325 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company has approximately $211 million of net operating loss (NOL) carryforwards associated with foreign subsidiaries, all of which have no expiration date. The carryforwards limitation period for the foreign tax credits has not begun. In addition, the Company has approximately $40 million of federal NOL carryforwards, which are subject to separate company limitations. These NOL carryforwards are scheduled to expire in 2023.

At November 30, 2003, $18 million of the valuation allowance relates to temporary differences resulting from the 1988 acquisition of E.F. Hutton Group, Inc. (now known as LB I Group Inc.) that are subject to separate company limitations. If future circumstances permit the recognition of the acquired tax benefit, then goodwill will be reduced.

## NOTE 20

## REGULATORY SETTLEMENT

In the fourth quarter of 2002, the Company recorded a pre-tax charge of $80 million ($56 million after-tax) associated with an agreement with various Federal and State regulatory authorities to settle inquiries related to alleged conflicts of interest involving equity research analysts. The agreement included certain organizational structural reforms, including providing independent research to clients in the future, as well as the payment of $80 million, including $50 million in retrospective relief, $5 million for investor education and $25 million (over the course of five years) to purchase independent research.

## NOTE 21 SEPTEMBER 11TH AND

## REAL ESTATE RECONFIGURATION COSTS

As a result of the September 11th, 2001 terrorist attack, the Company' s leased facilities in the World Trade Center ("WTC") were destroyed, and its leased and owned facilities in the World Financial Center ("WFC") complex (including the 3 WFC building owned jointly with American Express) were significantly damaged. All employees and operations in the downtown New York area were displaced. Key business activities and necessary support functions were quickly relocated to the Company' s back-up facilities in New Jersey and to various other temporary sites.



The Company had insurance in place to cover the losses resulting from the terrorist attack, including a policy covering damage to the core and shell of the 3 WFC building and a separate policy covering the property damage at the WTC and WFC facilities, losses resulting from business interruption and extra expenses associated with the Company' s relocation to, and occupancy of, the temporary facilities.

During 2001, the Company recognized a pre-tax charge of $127 million ($71 million after-tax) associated with the net losses stemming from the events of September 11, 2001. These losses and costs included the write-off of property damaged, destroyed or abandoned at the Company' s downtown facilities (approximately $340 million); compensation paid to employees in lieu of using external consultants for business recovery efforts and to employees for the time they were idled (approximately $100 million); costs incurred to maintain the facilities while they were unusable (approximately $16 million); and other costs associated with redeployment of the Company' s workforce to the temporary facilities (approximately $31 million). The losses and costs in 2001 were offset by estimated insurance recoveries of $360 million. All expenses associated with the Company' s use of temporary facilities during this period were reflected as part of Occupancy (approximately $18 million) or Technology and communications expenses (approximately $4 million) in the Consolidated Statement of Income. The insurance recovery recorded through November 30, 2001 was limited to the net historical book value of assets believed damaged, destroyed or abandoned and the out-of-pocket costs for certain extra expenses incurred during the period.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

During the fourth quarter of 2001, the Company purchased a new building in midtown Manhattan located at 745 Seventh Avenue and entered into long-term leases in Jersey City, New Jersey and midtown Manhattan, as uncertainties continued to persist associated with the Company' s ability to use its previous downtown headquarters at 3 WFC. During the fourth quarter of 2002, after further consideration of maintaining real estate in both downtown and midtown New York City locations, the Company decided to completely exit its downtown area facilities and dispose of certain other excess New York City area space acquired as a result of the events of September 11th, resulting in a charge of approximately $189 million. This charge is comprised of the estimated costs to dispose of facilities at the WFC, Jersey City, New Jersey and midtown Manhattan.

During the fourth quarter of 2002, the Company settled its insurance claim for $700 million, the policy limit, with its insurance carriers. The net gain of $108 million ($60 million after tax) included insurance recoveries of approximately $340 million, costs associated with exiting certain of the Company' s New York area facilities of $189 million, and $43 million of other costs resulting from the events of September 11th (primarily technology restoration and other costs associated with unusable facilities). Insurance recoveries represent the Company' s settlement of $700 million offset by insurance recoveries previously recognized of approximately $360 million during 2001.

During the fourth quarter of 2002, the Company recorded a $128 million pre-tax charge ($82 million after tax) for costs associated with reconfiguring certain global real estate facilities used by the Company to conduct its business activities. The charge resulted from management' s analysis of the Company' s global real estate needs and subsequent decisions made by management to no longer use certain facilities in Europe, Asia and the U.S. Approximately $115 million of the charge related to estimated sublease losses associated with the Company' s decision to exit its primary London office facilities at Broadgate and move its European headquarters to a new facility just outside the city of London, beginning in the fourth quarter of 2003. The remaining portion of the charge related to the Company' s decision to consolidate certain branch locations. These charges were recognized in accordance with EITF Issue No. 94-3, *"Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)."* The 2002 real estate reconfiguration charge is in addition to a $189 million charge (before consideration of insurance-related recoveries) recognized in 2002 associated with exiting facilities related to the events of September 11, 2001. During the second quarter of 2003, the Company recorded a $77 million pre-tax real estate charge ($45 million after tax). This charge represented an adjustment of the real estate charges recognized in 2002 and reflected a continued softening in the London and New York metropolitan area sublease markets since the fourth quarter of 2002.

The Company expects substantially all of such facilities will be subleased by the end of 2004. During the years ended November 30, 2003, 2002, and 2001 changes in the liability, which is included in Accrued liabilities and other payables in the Consolidated Statement of Financial Condition, related to these charges were as follows:

| IN MILLIONS | Beginning Balance | September 11th Charge Before Insurance Recoveries (2) | Real Estate Reconfiguration | Utilized (1) | Ending Balance |
|---|---|---|---|---|---|
| **YEAR ENDED NOVEMBER 30, 2001** | $ – | $ 487 | $ – | $ (423) | $ 64 |
| **YEAR ENDED NOVEMBER 30, 2002** | 64 | 232 | 128 | (78) | 346 |
| **YEAR ENDED NOVEMBER 30, 2003** | 346 | – | 77 | (27) | 396 |

(1) Net of interest accretions of $17 million in 2003.

(2) The Company recognized insurance recoveries of $360 million and $340 million in 2001 and 2002, respectively.



## NOTE 22 SEGMENTS

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The Company operates in three segments: Investment Banking, Capital Markets and Client Services.

The Investment Banking segment provides advice to corporate, institutional and government clients throughout the world on mergers, acquisitions and other financial matters. The segment also raises capital for clients by underwriting public and private offerings of debt and equity securities. The segment is composed of global industry groups−Communications and Media, Consumer/Retailing, Financial Institutions, Financial Sponsors, Healthcare, Industrial, Natural Resources, Power, Real Estate and Technology−that include bankers who deliver industry knowledge to meet clients' objectives. Specialized product groups within Mergers and Acquisitions and Global Finance, including Equity Capital Markets, Debt Capital Markets, Leveraged Finance and Private Placements, are partnered with global relationship managers in the global industry groups to provide comprehensive solutions for clients. Specialists in product development and derivatives also are engaged to tailor specific structures for clients.

The Capital Markets segment includes institutional customer flow activities, research, and secondary trading and financing activities in fixed income and equity products. These products include a wide range of cash, derivative, secured financing and structured instruments. The Company is a leading global market-maker in numerous equity and fixed income products including U.S., European and Asian equities, government and agency securities, money market products, corporate high grade, high yield and emerging market securities, mortgage- and asset-backed securities and real estate, preferred stock, municipal securities, bank loans, foreign exchange, financing and derivative products. The Company is one of the largest market-makers in terms of U.S. and pan-European listed equities trading volume and maintains a major presence in over-the-counter U.S. stocks, major Asian large capitalization stocks, warrants, convertible debentures and preferred issues. The segment also includes the risk arbitrage and secured financing businesses, as well as realized and unrealized gains and losses related to private equity investments. The secured financing business manages the Company' s equity and fixed income matched book activities, supplies secured financing to institutional clients and customers, and provides secured funding for the Company' s inventory of equity and fixed income products.

The Client Services segment consists of the Private Client and Asset Management business lines. Private Client generates customer-flow transactional fee revenues from high-net-worth clients and Asset Management generates fee-based revenues from customized investment management services for high-net-worth clients, as well as asset management fees from mutual fund and other institutional investors. Asset Management also generates management and incentive fees from the Company' s role as general partner for private equity and alternative investment partnerships. The Company' Private Equity business operates in five major asset classes: Merchant Banking, Real Estate, Venture Capital, Fixed Income-related and Third Party Funds.

The Company' s segment information for the years ended November 30, 2003, 2002 and 2001 is prepared using the following methodologies:

Revenues and expenses directly associated with each segment are included in determining earnings before taxes.
Expenses not directly associated with specific segments are allocated based on the most relevant measures applicable, including each segment' s revenues, headcount and other factors.
Net revenues include allocations of interest revenue and interest expense to securities and other positions in relation to the cash generated by, or funding requirements of, the underlying positions.
Segment assets include an allocation of indirect corporate assets that have been fully allocated to the Company' s business segments, generally based on each segment' s respective headcount figures.



**SEGMENTS**

| IN MILLIONS | Investment Banking | Capital Markets | Client Services | Total |
| --- | --- | --- | --- | --- |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | |
|---|---|---|---|---|
| **NOVEMBER 30, 2003** | | | | |
| Gross revenues | **$ 1,722** | **$ 14,628** | **$ 937** | **$ 17,287** |
| Interest expense | **–** | **8,610** | **30** | **8,640** |
| Net revenues | **1,722** | **6,018** | **907** | **8,647** |
| Depreciation and amortization expense | **55** | **219** | **41** | **315** |
| Other expenses | **1,266** | **3,792** | **661** | **5,719** |
| Earnings before taxes (1) (2) | **$ 401** | **$ 2,007** | **$ 205** | **$ 2,613** |
| Segment assets (billions) | **$ 1.4** | **$ 301.7** | **$ 9.0** | **$ 312.1** |
| **NOVEMBER 30, 2002** | | | | |
| Gross revenues | $ 1,731 | $ 14,225 | $ 825 | $ 16,781 |
| Interest expense | – | 10,605 | 21 | 10,626 |
| Net revenues | 1,731 | 3,620 | 804 | 6,155 |
| Depreciation and amortization expense | 45 | 188 | 25 | 258 |
| Other expenses | 1,276 | 2,534 | 588 | 4,398 |
| Earnings before taxes (1) (3) | $ 410 | $ 898 | $ 191 | $ 1,499 |
| Segment assets (billions) | $ 1.6 | $ 253.7 | $ 5.0 | $ 260.3 |
| **NOVEMBER 30, 2001** | | | | |
| Gross revenues | $ 1,925 | $ 19,605 | $ 862 | $ 22,392 |
| Interest expense | – | 15,581 | 75 | 15,656 |
| Net revenues | 1,925 | 4,024 | 787 | 6,736 |
| Depreciation and amortization expense | 25 | 134 | 15 | 174 |
| Other expenses | 1,527 | 2,568 | 592 | 4,687 |
| Earnings before taxes (1) (4) | $ 373 | $ 1,322 | $ 180 | $ 1,875 |
| Segment assets (billions) | $ 1.7 | $ 240.3 | $ 5.8 | $ 247.8 |

(1) Before dividends on preferred securities.

(2) Excludes the real estate reconfiguration charge of $77 million.

(3) Excludes the real estate reconfiguration charge of $128 million, September 11th related (recoveries)/expenses, net gain of ($108) million and regulatory settlement charge of $80 million.

(4) Excludes the September 11th related expenses, net of $127 million.



Net revenues, if origination or trading-related, are allocated to geographic regions based on the location where the primary or secondary position was fundamentally risk managed; if fee-related, by the location of the senior coverage banker; if commission-related, by the location of the salespeople. In addition, certain revenues associated with domestic products and services that resulted from relationships with international clients and customers have been reclassified as international revenues using an allocation consistent with the Company' s internal reporting.

## NET REVENUES BY GEOGRAPHIC REGION

| IN MILLIONS<br>YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 |
|---|---|---|---|
| Europe | **$ 1,864** | $ 1,674 | $ 1,955 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | |
|---|---|---|---|
| Asia Pacific | **875** | 612 | 540 |
| Total International | **2,739** | 2,286 | 2,495 |
| U.S. | **5,908** | 3,869 | 4,241 |
| Total | **$ 8,647** | $ 6,155 | $ 6,736 |

## NOTE 23 QUARTERLY INFORMATION (UNAUDITED)

The following table presents the Company' s unaudited quarterly results of operations for 2003 and 2002. Certain amounts reflect reclassifications to conform to the current period' s presentation. These quarterly results reflect all normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the results. Revenues and earnings of the Company can vary significantly from quarter to quarter due to the nature of the Company' s business activities.

| IN MILLIONS | **2003** | | | | **2002** | | | |
|---|---|---|---|---|---|---|---|---|
| **EXCEPT PER SHARE AMOUNTS** | **Nov. 30** | **Aug. 31** | **May 31** | **Feb. 28** | **Nov. 30** | **Aug. 31** | **May 31** | **Feb. 28** |
| Total revenues | **$ 4,254** | **$ 4,463** | **$ 4,470** | **$ 4,100** | $ 4,133 | $ 4,075 | $ 4,347 | $ 4,226 |
| Interest expense | **1,956** | **2,116** | **2,179** | **2,389** | 2,594 | 2,728 | 2,684 | 2,620 |
| Net revenues | **2,298** | **2,347** | **2,291** | **1,711** | 1,539 | 1,347 | 1,663 | 1,606 |
| Non-interest expenses: | | | | | | | | |
| Compensation and benefits | **1,103** | **1,174** | **1,168** | **873** | 785 | 687 | 848 | 819 |
| Nonpersonnel expenses | **473** | **424** | **418** | **401** | 400 | 391 | 379 | 347 |
| September 11th related recoveries, net | **–** | **–** | **–** | **–** | (108) | – | – | – |
| Other real estate reconfiguration charge | **–** | **–** | **77** | **–** | 128 | – | – | – |
| Regulatory settlement | **–** | **–** | **–** | **–** | 80 | – | – | – |
| Total non-interest expenses | **1,576** | **1,598** | **1,663** | **1,274** | 1,285 | 1,078 | 1,227 | 1,166 |
| Income before taxes and dividends on trust preferred securities | **722** | **749** | **628** | **437** | 254 | 269 | 436 | 440 |
| Provision for income taxes | **220** | **250** | **173** | **122** | 53 | 61 | 126 | 128 |
| Dividends on trust preferred securities | **21** | **19** | **18** | **14** | 14 | 14 | 14 | 14 |
| Net income | **$ 481** | **$ 480** | **$ 437** | **$ 301** | $ 187 | $ 194 | $ 296 | $ 298 |
| Net income applicable to common stock | **$ 464** | **$ 469** | **$ 426** | **$ 290** | $ 176 | $ 183 | $ 285 | $ 262 |
| Weighted-average shares | | | | | | | | |
| Basic | **254.7** | **243.8** | **242.3** | **241.8** | 243.9 | 246.7 | 245.8 | 245.3 |
| Diluted | **271.2** | **259.5** | **255.8** | **253.0** | 255.1 | 261.0 | 263.5 | 265.2 |
| Earnings per common share | | | | | | | | |
| Basic | **$ 1.82** | **$ 1.92** | **$ 1.76** | **$ 1.20** | $ 0.72 | $ 0.74 | $ 1.16 | $ 1.07 |
| Diluted | **$ 1.71** | **$ 1.81** | **$ 1.67** | **$ 1.15** | $ 0.69 | $ 0.70 | $ 1.08 | $ 0.99 |
| Dividends per common share | **$ 0.12** | **$ 0.12** | **$ 0.12** | **$ 0.12** | $ 0.09 | $ 0.09 | $ 0.09 | $ 0.09 |
| Book value per common share (at period end) | **$ 44.17** | **$ 37.95** | **$ 36.77** | **$ 35.03** | $ 34.15 | $ 33.49 | $ 33.22 | $ 32.47 |



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

The following table summarizes certain consolidated financial information included in the audited Consolidated Financial Statements.

## SELECTED FINANCIAL DATA

| IN MILLIONS, EXCEPT PER SHARE DATA, OTHER DATA AND FINANCIAL RATIOS YEAR ENDED NOVEMBER 30 | 2003 | 2002 | 2001 | 2000 | 1999 |
|---|---|---|---|---|---|
| **CONSOLIDATED STATEMENT OF INCOME** | | | | | |
| Revenues: | | | | | |
| Principal transactions | **$ 4,280** | $ 1,951 | $ 2,779 | $ 3,713 | $ 2,341 |
| Investment banking | **1,747** | 1,771 | 2,000 | 2,216 | 1,682 |
| Commissions | **1,210** | 1,286 | 1,091 | 944 | 651 |
| Interest and dividends | **9,942** | 11,728 | 16,470 | 19,440 | 14,251 |
| Other | **108** | 45 | 52 | 134 | 64 |
| Total revenues | **17,287** | 16,781 | 22,392 | 26,447 | 18,989 |
| Interest expense | **8,640** | 10,626 | 15,656 | 18,740 | 13,649 |
| Net revenues | **8,647** | 6,155 | 6,736 | 7,707 | 5,340 |
| Non-interest expenses: | | | | | |
| Compensation and benefits | **4,318** | 3,139 | 3,437 | 3,931 | 2,707 |
| Nonpersonnel expenses | **1,716** | 1,517 | 1,424 | 1,197 | 1,002 |
| Other real estate reconfiguration charge | **77** | 128 | – | – | – |
| September 11th related (recoveries)/expenses, net | – | (108) | 127 | – | – |
| Regulatory settlement | – | 80 | – | – | – |
| Total non-interest expenses | **6,111** | 4,756 | 4,988 | 5,128 | 3,709 |
| Income before taxes and dividends on trust preferred securities | **2,536** | 1,399 | 1,748 | 2,579 | 1,631 |
| Provision for income taxes | **765** | 368 | 437 | 748 | 457 |
| Dividends on trust preferred securities | **72** | 56 | 56 | 56 | 42 |
| Net income | **$ 1,699** | $ 975 | $ 1,255 | $ 1,775 | $ 1,132 |
| Net income applicable to common stock | **$ 1,649** | $ 906 | $ 1,161 | $ 1,679 | $ 1,037 |
| **CONSOLIDATED STATEMENT OF FINANCIAL CONDITION (AT PERIOD END)** | | | | | |
| Total assets | **$ 312,061** | $ 260,336 | $ 247,816 | $ 224,720 | $ 192,244 |
| Net assets (a) | **166,282** | 143,291 | 144,643 | 125,680 | 110,487 |
| Long-term debt (b) | **43,529** | 38,678 | 38,301 | 35,233 | 30,691 |
| Preferred securities subject to mandatory redemption | **1,310** | 710 | 710 | 860 | 710 |
| Total stockholders' equity | **13,174** | 8,942 | 8,459 | 7,781 | 6,283 |
| Total capital (c) | **58,013** | 48,330 | 47,470 | 43,874 | 37,684 |
| **PER SHARE DATA** (d) | | | | | |
| Net income (diluted) (e) | **$ 6.35** | $ 3.47 | $ 4.38 | $ 6.38 | $ 4.08 |
| Dividends declared per common share | **$ 0.48** | $ 0.36 | $ 0.28 | $ 0.22 | $ 0.18 |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | |
|---|---|---|---|---|---|
| Book value per common share (at period end) (f) | **$ 44.17** | $ 34.15 | $ 31.81 | $ 28.78 | $ 22.75 |
| **OTHER DATA (AT PERIOD END)** | | | | | |
| Gross leverage (g) | **23.7x** | 29.1x | 29.3x | 28.9x | 30.6x |
| Net leverage (h) | **15.6x** | 15.2x | 16.1x | 14.9x | 16.1x |
| Employees | **16,188** | 12,343 | 13,090 | 11,326 | 8,893 |
| **FINANCIAL RATIOS (%)** | | | | | |
| Compensation and benefits/net revenues | **49.9** | 51.0 | 51.0 | 51.0 | 50.7 |
| Pretax operating margin (i) | **29.3** | 22.7 | 26.0 | 33.5 | 30.5 |
| Effective tax rate (j) | **30.2** | 26.3 | 25.0 | 29.0 | 28.0 |
| Return on average common stockholders' equity (k) | **18.2** | 11.2 | 15.9 | 26.6 | 20.8 |
| Return on average tangible common stockholders' equity (l) | **19.2** | 11.5 | 16.3 | 27.2 | 21.4 |

(a) Net assets represents total assets excluding secured financing arrangements, collateral received recognized in inventory pursuant to SFAS 140, goodwill and other identifiable intangibles. The Company believes net assets is useful to investors when comparing companies in the securities industry because it excludes certain assets considered to have a low risk profile. Net assets as presented by the Company is not necessarily comparable to similarly-titled measures presented by other companies in the securities industry because of different methods of calculation.

(b) Long-term debt includes senior notes and subordinated indebtedness.

(c) Total capital includes long-term debt, preferred securities subject to mandatory redemption and total stockholders' equity. The Company believes total capital is useful to investors as a measure of the Company's financial strength.

(d) All 1999 share and per share data have been restated for the two-for-one common stock split effective October 2000.

(e) Diluted EPS was reduced by $0.17 as a result of the 2003 real estate charge, $0.30 in 2002 as a result of the real estate reconfiguration charge, September 11th related (recoveries)/expenses, net and regulatory settlement charge and $0.26 in 2001 as a result of September 11th related expenses, net. For the years ended November 30, 2000 and 1999, the assumed conversion of Series A and B Convertible Preferred Stock into 2,438,375 and 5,559,474 common shares had the effect of decreasing diluted earnings per share by $0.03 and $0.02, respectively.

(f) The book value per common share calculation includes restricted stock units granted under Lehman Brothers Stock Award Programs that have been included in total stockholders' equity.

(g) Gross leverage ratio is defined as total assets divided by total stockholders' equity.

(h) Net leverage ratio is defined as net assets (total assets excluding secured financing arrangements, collateral received recognized in inventory pursuant to SFAS 140, goodwill and other identifiable intangible assets) divided by tangible equity capital (stockholders' equity and preferred securities subject to mandatory redemption less goodwill and other identifiable intangible assets). See pages 51 and 52 for the calculations of net assets and tangible equity capital. The Company believes net assets to be a useful measure as this is used by certain rating agencies when evaluating leverage as it excludes assets of a low-risk nature. The Company believes net leverage, based on net assets as defined above, divided by tangible equity capital, to be a more meaningful measure of leverage in evaluating companies in the securities industry and is used by many of the Company's creditors and a leading rating agency. The Company believes tangible equity capital to be a more representative measure of the Company's equity for purposes of calculating net leverage because the Company does not view the amount of equity used to support goodwill and other identifiable intangible assets as available to support the Company's net assets. These measures are not necessarily comparable to similarly-titled measures provided by other companies because of different methods of calculation.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

(i) Pre-tax margin was reduced by approximately 0.9% in 2003 as a result of the real estate charge, approximately 1.7% in 2002 as a result of the real estate reconfiguration charge, September 11th related (recoveries)/expenses, net and regulatory settlement charge and reduced by approximately 1.8% in 2001 as a result of September 11th related expenses, net.

(j) The effective tax rate declined by approximately 0.3% in 2003, as a result of the real estate charge. The effective tax rate increased by approximately 0.3% in 2002, as a result of the real estate reconfiguration charge, September 11th related (recoveries)/expenses, net and regulatory settlement charge. The effective tax rate declined by approximately 1.3% in 2001, as a result of September 11th related expenses, net.

(k) In this calculation, average common stockholders' equity was appropriately weighted for the effect of equity issued in connection with the Neuberger acquisition on October 31, 2003. Return on average common stockholders' equity is computed by dividing net income applicable to common stock for the period by average common stockholders' equity. Average common stockholder' s equity for the years ended November 2003, 2002, 2001, 2000, and 1999 were $9,061 million, $8,066 million, $7,286 million, $6,319 million and $4,987 million, respectively. Return on average common stockholders' equity was reduced by 0.5% in 2003 as a result of the real estate charge, 1.0% in 2002, as a result of the real estate reconfiguration charge, September 11th related (recoveries)/expenses, net and regulatory settlement charge and 1.0% in 2001, as a result of September 11th related expenses, net.

(l) Average tangible common stockholders' equity equals total common stockholders' equity less goodwill and identifiable intangible assets. Average identifiable intagible assets and goodwill for the years ended November 2003, 2002, 2001, 2000 and 1999 were $471 million, $191 million, $174 million, $142 million, $149 million, respectively. Management believes tangible common stockholders' equity is a meaningful measure because it reflects the common stockholders' equity deployed in the Company' s businesses. In this calculation, average tangible common stockholders' equity was appropriately weighted for the effect of equity issued in connection with the Neuberger acquisition on October 31, 2003. Return on average tangible common stockholders' equity is computed by dividing net income applicable to common stock for the period by average tangible common stockholders' equity. Return on average tangible common stockholders' equity was reduced by 0.5% in 2003, as a result of the real estate charge, 1.0% in 2002 as a result of the real estate reconfiguration charge, September 11th related (recoveries)/expenses, net and the regulatory settlement and 0.9% in 2001 as a result of September 11th related expenses, net.



## OTHER STOCKHOLDER INFORMATION

**COMMON STOCK TICKER SYMBOL: LEH** The common stock of Lehman Brothers Holdings Inc., par value $0.10 per share, is listed on the New York Stock Exchange and on the Pacific Exchange. As of January 31, 2004, there were approximately 266,247,589 shares of the Company' s common stock outstanding and 22,630 holders of record. On January 31, 2004, the last reported sales price of Lehman Brothers' common stock was $82.10.

Lehman Brothers Holdings currently is authorized to issue up to 600,000,000 shares of common stock. Each holder of common stock is entitled to one vote per share for the election of directors and all other matters to be voted on by stockholders. Holders of common stock may not cumulate their votes in the election of directors. They are entitled to share equally in the dividends that may be declared by the Board of Directors, after payment of dividends on preferred stock. Upon voluntary or involuntary liquidation, dissolution or winding up of the Company, holders of common stock will share ratably in the assets remaining after payments to creditors and provision for the preference of any preferred stock. There are no preemptive or other subscription rights, "poison pills", conversion rights or redemption or scheduled installment payment provisions relating to common stock.

**PREFERRED STOCK** Lehman Brothers Holdings currently is authorized to issue up to 38,000,000 shares of preferred stock, par value $1.00 per share. Lehman Brothers' Board of Directors may authorize the issuance of classes or series of preferred stock from time to time, each with the voting rights, preferences and other special rights and qualifications, limitations or restrictions specified by the Board. A series of preferred stock may rank as senior, equal or subordinate to another series of preferred stock. Each series of preferred stock will rank prior to the common stock as to dividends and distributions of assets.

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

As of January 31, 2004, Lehman Brothers has issued and outstanding 780,000 shares of preferred stock in five series (each represented by depositary shares) with differing rights and privileges. The outstanding preferred stock does not have voting rights, except in certain very limited circumstances involving the Company' s failure to pay dividends thereon and certain matters affecting the specific rights of the preferred stockholders.

**ANNUAL MEETING** Lehman Brothers' annual meeting of stockholders will be held on Friday, April 2, 2004 at 10:30 a.m. at its global headquarters at 745 Seventh Avenue, New York, New York 10019 in the Allan S. Kaplan Auditorium on the Concourse Level.

**DIVIDENDS** Effective January 2004, Lehman Brothers' Board of Directors increased the fiscal 2004 dividend rate to $0.64 per common share from an annual dividend rate of $0.48 per share in fiscal 2003. Dividends on the Company' s common stock are generally payable, following declaration by the Board of Directors, in February, May, August and November.

**REGISTRAR AND TRANSFER AGENT FOR COMMON STOCK** Questions regarding dividends, transfer requirements, lost certificates, changes of address, direct deposit of dividends, the Direct Purchase and Dividend Reinvestment Plan, or other inquiries should be directed to:

The Bank of New York
Shareholders Services Department
P.O. Box 11258
Church Street Station
New York, New York 10286-1258

Telephone: (800) 824-5707 (U.S.)
(610) 382-7833 (non-U.S.)
E-mail: shareowner-svcs@bankofny.com
Website: http://www.stockbny.com

**DIRECT PURCHASE AND DIVIDEND REINVESTMENT PLAN** Lehman Brothers' Direct Purchase and Dividend Reinvestment Plan provides both existing stockholders and first-time investors with an alternative means of purchasing the Company' s stock. The plan has no minimum stock ownership requirements for eligibility and enrollment. Plan participants may reinvest all or a portion of cash dividends and/or make optional cash purchases up to a maximum of $175,000 per year without incurring commissions or service charges. Additional information and enrollment forms can be obtained from the Company' s Transfer Agent listed above.

**ANNUAL REPORT AND FORM 10-K** Lehman Brothers will make available upon request, without charge, copies of this Annual Report and the 2003 Annual Report on Form 10-K as filed with the Securities and Exchange Commission. Requests may be directed to:

Jeffrey A. Welikson, Corporate Secretary
Lehman Brothers Holdings Inc.
399 Park Avenue, New York, New York 10022
Telephone: (212) 526-0858

**INDEPENDENT AUDITORS**

Ernst & Young LLP
5 Times Square
New York, New York 10036
Telephone: (212) 773-3000

**INVESTOR RELATIONS**

(212) 526-3267

**MEDIA RELATIONS**

(212) 526-4382

**WEBSITE ADDRESS**

http://www.lehman.com

**PRICE RANGE OF COMMON STOCK**

| THREE MONTHS ENDED 2003 | Nov. 30 | Aug. 31 | May 31 | Feb. 28 |
|---|---|---|---|---|
| HIGH | $ 74.58 | $ 75.80 | $ 72.01 | $ 60.46 |
| LOW | $ 66.46 | $ 60.80 | $ 51.80 | $ 50.37 |

| THREE MONTHS ENDED 2002 | Nov. 30 | Aug. 31 | May 31 | Feb. 28 |
|---|---|---|---|---|

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| HIGH | $ | 63.20 | $ | 62.65 | $ | 66.52 | $ | 69.52 |
| LOW | $ | 42.59 | $ | 50.61 | $ | 57.22 | $ | 55.43 |



Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 21.01**

## LIST OF THE REGISTRANT' S SUBSIDIARIES

*Pursuant to Item 601(b)(21)(ii) of Regulation S-K, certain subsidiaries of the Registrant have been omitted which, considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary (as defined in Rule 1-02(w) of Regulation S-X) as of November 30, 2003.*

| Company | Jurisdiction of Incorporation |
|---|---|
| Lehman Brothers Holdings Inc. | Delaware |
| ALS Holding Inc. | Delaware |
| Aurora Loan Services Inc. | Delaware |
| Banque Lehman Brothers S.A. | France |
| BNC Holdings Inc. | Delaware |
| BNC Mortgage Inc. | Delaware |
| DA Group Holdings Inc. | Delaware |
| LB 745 LLC | Delaware |
| LBAC Holdings I Inc. | Delaware |
| Lehman Brothers Asia Capital Company | Hong Kong |
| LBCCA Holdings I Inc. | Delaware |
| Falcon Holdings I LLC | Delaware |
| Falcon Holdings II Inc. | Cayman Islands |
| CIMT Limited | Cayman Islands |
| TMIC Limited | Cayman Islands |
| MICT Limited | Cayman Islands |
| Global Thai Property Fund | Thailand |
| Falcon Holdings III Inc. | Cayman Islands |
| Falcon Holdings IV Inc. | Cayman Islands |
| Global Thai Finance Limited | Thailand |
| Global Thai Securities Limited | Thailand |
| Revival Holdings Limited | Cayman Islands |
| Sunrise Finance Co., Ltd. | Japan |
| Lehman Brothers Asia Capital Company | Hong Kong |
| Lehman Brothers Commercial Corporation Asia Limited | Hong Kong |
| LBCCA Holdings II Inc. | Delaware |
| Falcon Holdings I LLC | Delaware |
| Falcon Holdings II Inc. | Cayman Islands |
| CIMT Limited | Cayman Islands |
| TMIC Limited | Cayman Islands |
| MICT Limited | Cayman Islands |
| Global Thai Property Fund | Thailand |
| Falcon Holdings III Inc. | Cayman Islands |
| Falcon Holdings IV Inc. | Cayman Islands |
| Global Thai Finance Limited | Thailand |
| Global Thai Securities Limited | Thailand |
| Revival Holdings Limited | Cayman Islands |
| Sunrise Finance Co., Ltd. | Japan |
| Lehman Brothers Commercial Corporation Asia Limited | Hong Kong |
| LB Delta Funding Ltd. | Cayman Islands |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| LB Delta (Cayman) No 1 Ltd. | Cayman Islands |
| LB Delta (Cayman) No 2 Ltd. | Cayman Islands |
| LBHK Funding (Cayman) No. 4 Ltd. | Cayman Islands |
| LBHK Funding (Cayman) No. 1 Ltd. | Cayman Islands |
| LBHK Funding (Cayman) No. 2 Ltd. | Cayman Islands |
| LBO Funding (Cayman) Limited | Cayman Islands |
| Lehman Brothers Hong Kong Olympus Funding L.P. | Cayman Islands |
| LBQ Funding (Cayman) Limited | Cayman Islands |
| LBQ Hong Kong Services Limited | Hong Kong |
| LB Vin Co Inc. | Delaware |

---

| | |
|---|---|
| Lehman ALI Inc. | Delaware |
| 314 Commonwealth Ave. Inc. | Delaware |
| Stockholm Investments Limited | Cayman Islands |
| Lehman CMBS Funding Inc. | Delaware |
| LUBS Inc. | Delaware |
| Property Asset Management Inc. | Delaware |
| Lehman Brothers Global Investments LLC | Delaware |
| New Century Finance Co., LTD | Japan |
| Lehman Syndicated Loan Funding Inc. | Delaware |
| Lehman Brothers AIM Holdings LLC | Delaware |
| Lehman Brothers Alternative Investment Management LLC | Delaware |
| Lehman Brothers Bancorp Inc. | Delaware |
| Lehman Brothers Bank, FSB | Delaware |
| Lehman Brothers Canada Inc. | Canada |
| Lehman Brothers Commercial Corporation | Delaware |
| Lehman Brothers Finance S.A. | Switzerland |
| Lincoln Capital Fixed Income Management Company, LLC | Delaware |
| Lehman Brothers Asset Management Inc. | Delaware |
| Lehman Brothers Futures Asset Management Corp. | Delaware |
| Lehman Brothers Holdings Capital Trust I | Delaware |
| Lehman Brothers Holdings Capital Trust II | Delaware |
| Lehman Brothers Holdings Capital Trust III | Delaware |
| Lehman Brothers Holdings Capital Trust IV | Delaware |
| Lehman Brothers Inc. | Delaware |
| Lehman Brothers Asia Limited | Hong Kong |
| Lehman Brothers Derivative Products Inc. | Delaware |
| Lehman Brothers Financial Products Inc. | Delaware |
| Lehman Brothers Investment Holding Company Inc. | Delaware |
| Lehman Brothers Asia Holdings Limited | Hong Kong |
| Lehman Brothers Asia Limited | Hong Kong |
| Lehman Brothers Nominees (H.K.) Limited | Hong Kong |
| Lehman Brothers Equity Finance (Cayman) Limited | Cayman Islands |
| Lehman Brothers Futures Asia Limited | Hong Kong |
| Lehman Brothers Pte Ltd. | Singapore |
| LBQ Hong Kong Funding Ltd. | Hong Kong |
| Lehman Brothers Securities Asia Limited | Hong Kong |
| Lehman Brothers Special Financing Inc. | Delaware |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| Lehman Commercial Paper Inc | New York |
| LCPI Properties Inc. | New Jersey |
| LW-LP Inc. | Delaware |
| Lehman CMO Inc. | Maryland |
| Lehman ABS Corporation | Delaware |
| Lehman Pass-Through Securities Inc. | Delaware |
| Lehman Structured Securities Corp. | Delaware |
| Lehman Syndicated Loan Inc. | Delaware |
| Structured Asset Securities Corporation | Delaware |
| LB I Group Inc. | Delaware |
| DL Mortgage Corp. | Delaware |
| LB-NL Holdings I Inc. | Delaware |
| LB-NL Holdings L.P. | Delaware |
| LB-NL U.S. Investor Inc | Delaware |
| NL Funding, L.P. | Delaware |
| LB-NL Holdings II Inc. | Delaware |
| LB-NL Holdings L.P. | Delaware |
| LB-NL U.S. Investor Inc | Delaware |
| NL Funding, L.P. | Delaware |
| LBQ Hong Kong Funding Ltd. | Hong Kong |
| LBQ Hong Kong Services Limited | Hong Kong |
| Lehman Insurance Company | Arizona |
| Lehman VIP Holdings Inc. | Delaware |
| RIBCO SPC, Inc. | Delaware |
| RIBCO LLC | Delaware |

---

| | |
|---|---|
| Lehman Brothers Insurance Agency L.L.C. | Delaware |
| Lehman Brothers Investments Pte Limited | Singapore |
| Lehman Brothers Japan Inc. | Cayman Islands |
| Lehman Brothers (Luxembourg) S.A. | Luxembourg |
| Lehman Brothers Private Equity Advisers L.L.C. | Delaware |
| Lehman Brothers Private Funds Investment Company LP, LLC | Delaware |
| Lehman Brothers Private Funds Investment Company GP, LLC | Delaware |
| Lehman Crossroads Investment Advisers, LP | Delaware |
| Lehman Crossroads Corporate Investors, LP | Delaware |
| Lehman Crossroads Corporate Investors II, LP | Delaware |
| Lehman Crossroads Investment Company, LP | Delaware |
| The Main Office Management Company, LP | Delaware |
| Capital Analytics II, LP | Delaware |
| e-Valuate, LP | Delaware |
| Security Assurance Advisers, LP | Delaware |
| Lehman Brothers Realty Corp. | Delaware |
| Lehman Brothers U.K. Holdings (Delaware) Inc. | Delaware |
| Ballybunion Investments Limited | Cayman Islands |
| Ballybunion Investments No. 2 Limited | Cayman Islands |
| Ballybunion Investments No. 3 Limited | Cayman Islands |
| Lehman Brothers Spain Holdings Limited | United Kingdom |
| Lehman Brothers Luxembourg Investments Sarl | Luxembourg |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

| | |
|---|---|
| LB Funding BV | The Netherlands |
| Lehman Brothers UK Investments Limited | United Kingdom |
| LB Investments (UK) Limited | United Kingdom |
| Lehman Brothers U.K. Holdings Ltd. | United Kingdom |
| Lehman Brothers (PTG) Limited | United Kingdom |
| Eldon Street Holdings | United Kingdom |
| Thayer Properties Limited | United Kingdom |
| Thayer Group Limited | Jersey |
| MABLE Commercial Funding Limited | United Kingdom |
| Platform Commercial Mortgage Limited | United Kingdom |
| Lehman Brothers Holdings Plc. | United Kingdom |
| Resetfan Limited | United Kingdom |
| Southern Pacific Mortgage Limited | United Kingdom |
| SPML Mortgage Funding Limited | United Kingdom |
| LB Cayman Finance Limited | Cayman Islands |
| LBO Investments Limited | United Kingdom |
| LBQ Funding (UK) Limited | United Kingdom |
| LB Lomond Investments Limited | United Kingdom |
| LB Australia and Asia Investments Limited | Cayman Islands |
| Lehman Brothers International (Europe) | United Kingdom |
| Seebreeze Funding Limited | United Kingdom |
| Lehman Brothers Europe Limited | United Kingdom |
| Lehman Brothers Limited | United Kingdom |
| Lehman Brothers Treasury Co. B.V. | The Netherlands |
| Lehman Brothers Capital GmbH, Co. | Germany |
| Lehman Brothers Verwaltungs-und Beteiligungsgesellschaft mbH | Germany |
| Lehman Brothers Bankhaus Aktiengesellschaft | Germany |
| Lehman Investments Inc. | Delaware |
| Lehman Re Ltd. | Bermuda |
| Lehman Risk Advisors Inc. | Delaware |
| Lehman Structured Assets Inc. | Delaware |
| MMP Funding Corp. | Delaware |
| Neuberger Berman Inc. | Delaware |
| Neuberger Berman Management Inc. | New York |
| Neuberger Berman Asset Management, LLC | Delaware |
| Neuberger Berman Trust Co., N.A. | United States of America |
| Sage Partners, LLC | New York |
| Executive Monetary Management, Inc. | New York |
| Neuberger Berman, LLC | Delaware |
| Neuberger Berman Pty Ltd. | Australia |
| Neuberger Berman Trust Co. of Delaware | Delaware |
| Neuberger & Berman Agency, Inc. | New York |
| Principal Transactions Inc. | Delaware |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 23.01**

## CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in this 2003 Annual Report on Form 10-K of Lehman Brothers Holdings Inc. (the "Company") of our report dated January 29, 2004, included in the 2003 Annual Report to Stockholders of the Company.

Our audit also included the financial statement schedule of the Company listed in Item 15(a). This schedule is the responsibility of the Company' s management. Our responsibility is to express an opinion based on our audits. In our opinion, the financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also consent to the incorporation by reference in the Registration Statements and Post Effective Amendments of the Company on Form S-3 File Nos. 33-53651, 33-56615, 33-58548, 33-62085, 33-65674, 333-14791, 333-30901, 333-38227, 333-44771, 333-50197, 333-60474, 333-61878, 333-64899, 333-75723, 333-76339 and 333-108711-01 and on Form S-8 File Nos. 33-53923, 33307875, 333-57239, 333-59184, 333-68247, 333-110179 and 333-110180 and Registration Statements and Post Effective Amendments of Lehman Brothers Inc. on Form S-3 File Nos. 333-51913, 333-08319, 033-63613, 033-28381, 002-95523 and 002-83903, and in the related Prospectuses, of our report dated January 29, 2004, with respect to the consolidated financial statements and financial statement schedule of the Company included or incorporated by reference in this Annual Report on Form 10-K for the year ended November 30, 2003.

*Ernst & Young LLP*

New York, New York
February 26, 2004

---

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 24.01**

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Thomas A. Russo, Joseph Polizzotto and Jeffrey A. Welikson, and each of them, his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K of Lehman Brothers Holdings Inc., for the fiscal year ended November 30, 2003, and any and all amendments thereto, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Dated: As of February 26, 2004

| Signature | Title |
|---|---|
| /s/ RICHARD S. FULD, JR.<br>Richard S. Fuld, Jr. | Chief Executive Officer and<br>Chairman of the Board of Directors<br>(principal executive officer) |
| /s/ DAVID GOLDFARB<br>David Goldfarb | Chief Financial Officer and<br>Executive Vice President<br>(principal financial and accounting officer) |
| /s/ MICHAEL L. AINSLIE<br>Michael L. Ainslie | Director |
| /s/ JOHN F. AKERS<br>John F. Akers | Director |
| /s/ ROGER S. BERLIND<br>Roger S. Berlind | Director |
| /s/ THOMAS H. CRUIKSHANK<br>Thomas H. Cruikshank | Director |
| /s/ CHRISTOPHER GENT<br>Sir Christopher Gent | Director |
| /s/ HENRY KAUFMAN<br>Henry Kaufman | Director |
| /s/ JOHN D. MACOMBER<br>John D. Macomber | Director |
| /s/ DINA MERRILL | Director |

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

Dina Merrill

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 31.01**

**CERTIFICATION**

I, Richard S. Fuld, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of Lehman Brothers Holdings Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting;

5. The registrant' s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: February 26, 2004

*/s/ Richard S. Fuld, Jr.*

Richard S. Fuld, Jr.
Chairman and Chief Executive Officer

---

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 31.02**

**CERTIFICATION**

I, David Goldfarb, certify that:

1. I have reviewed this annual report on Form 10-K of Lehman Brothers Holdings Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting;

5. The registrant' s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: February 26, 2004

*/s/ David Goldfarb*
David Goldfarb
Chief Financial Officer and
Executive Vice President

---

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 32.01**

**CERTIFICATION**
**PURSUANT TO 18 U.S.C. SECTION 1350,**
**AS ENACTED BY**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), I, Richard S. Fuld, Jr., certify that:

1. The Annual Report on Form 10-K for the year ended November 30, 2003 (the "Report") of Lehman Brothers Holdings Inc. (the "Company") as filed with the Securities and Exchange Commission as of the date hereof, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 26, 2004

*/s/ Richard S. Fuld, Jr.*
Richard S. Fuld, Jr.
Chairman and Chief Executive Officer

*A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Lehman Brothers Holdings Inc. and will be retained by Lehman Brothers Holdings Inc. and furnished to the Securities and Exchange Commission or its staff upon request.*

---

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document

**EXHIBIT 32.02**

**CERTIFICATION**
**PURSUANT TO 18 U.S.C. SECTION 1350,**
**AS ENACTED BY**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), I, David Goldfarb, certify that:

1. The Annual Report on Form 10-K for the year ended November 30, 2003 (the "Report") of Lehman Brothers Holdings Inc. (the "Company") as filed with the Securities and Exchange Commission as of the date hereof, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 26, 2004

*/s/ David Goldfarb*
David Goldfarb
Chief Financial Officer and
Executive Vice President

*A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Lehman Brothers Holdings Inc. and will be retained by Lehman Brothers Holdings Inc. and furnished to the Securities and Exchange Commission or its staff upon request.*

---

Copyright © 2012 www.secdatabase.com. All Rights Reserved.
Please Consider the Environment Before Printing This Document