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First Response to the January 28 and February 3, 2010 Letters of the Financial Crisis Inquiry Commission- Lloyd Blankfein Former CEO of Goldman Sachs Response to Hearing Follow-Up Questions

Lloyd Blankfein

United States: Financial Crisis Inquiry Commission (FCIC)

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Recommended Citation

Blankfein, Lloyd and United States: Financial Crisis Inquiry Commission (FCIC), "First Response to the January 28 and February 3, 2010 Letters of the Financial Crisis Inquiry Commission- Lloyd Blankfein Former CEO of Goldman Sachs Response to Hearing Follow-Up Questions" (2010). *YPFS Documents*. 4992.

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**First Response to the January 28 and
February 3, 2010 Letters of the Financial Crisis Inquiry Commission**

Responses to the Commission's January 28, 2010 Letter

1. Did Goldman prepare any kind of internal investigation, audit, or similar review regarding its business practices, including mistakes made, that contributed to the financial problems experienced by the bank in 2008? If so, please provide the internal review. If no review was performed, please explain why.

With the exception of an informal review of our leveraged lending approval process (included in Appendix 1), we do not view ourselves as having conducted any such review, primarily because our overall results in 2008 confirmed that our business practices and procedures had functioned well in the circumstances (Goldman Sachs recorded net profits in 2008 of \$2.3 billion).

Nevertheless, in response to the events of 2008, we did take a number of significant steps intended to increase our financial strength. For example, between fiscal year-end 2007 and fiscal year-end 2009:

- We reduced our leverage ratio from 26.2 times to 12.0 times;
- We reduced our balance sheet size from \$1,120 billion to \$849 billion (a 24% decrease);
- We raised additional capital of \$16.5 billion (excluding the government's investment under the TARP program, which has since been fully repaid), and increased our total shareholders' equity from \$42.8 billion to \$70.7 billion (a 65% increase);
- We increased our average "Global Core Excess" (i.e., the pool of unencumbered, highly liquid securities that may be sold or pledged to provide same-day liquidity) from \$64 billion to \$166 billion;
- We reduced our level 3 illiquid assets from \$69.2 billion to \$46.5 billion (a 33% decrease).

2. You testified that Goldman had research before 2007 that showed it was very negative on the housing markets. Please provide that research and any related research.

Goldman Sachs Economic Research expressed an increasing level of concern about the run up in housing prices in papers dating back to at least 2004. The following research papers have been provided in Appendix 2:

- 1) US Economics Analyst Issue No. 04/42: "Trouble Brews in the Housing Market", dated October 15, 2004
- 2) "The Pocket Chartroom: The Wile E. Coyote Economy" issue for September / October 2005
- 3) Global Economics Paper No. 137: "Housing Holds the Key to Fed Policy", dated February 3, 2006
- 4) US Economics Analyst Issue No. 06/36: "An Outright Decline in Home Prices Next Year", dated September 8, 2006

3. Please provide a list of every securitization (including mortgage-backed securities ("MBS"), collateralized debt obligations ("CDO"), or other structured products) organized, issued, arranged, sponsored, advised, managed, underwritten or sold by Goldman between January 1, 2006 and the present, ("Goldman Securitizations"), including the issuing entity, the date and type of the initial registration statement or private placement memorandum ("PPM"), the date of the final registration statement and prospectus or PPM, the dollar amount of the securitization, the types of securities being sold, and the performance of the securities from the date of issuance to the present, including the credit rating and market value as a percentage of issuance price.

Appendix 3 contains a list of all non-agency residential mortgage-backed securitizations, commercial mortgage-backed securitizations and collateralized debt obligations either underwritten or issued by affiliates of the firm from January 1, 2006 through the present date (hereinafter "Goldman Securitizations"). For each deal, we have included the CUSIP numbers of the securities issued, together with the tranche name, tranche description and original outstanding tranche balance associated with each CUSIP. We no longer hold a position in most of these CUSIPs, and we do not track the current market prices for positions that we do not hold. Accordingly, in order to demonstrate deal performance, we have included the original rating and current rating issued by Fitch, Moody's and S&P for each security. Finally, we have provided the closing date for each transaction and the registration type for each CUSIP issued.

4. (a) Please provide the names of all entities that rated or (b.) were asked to rate the securitizations referenced above. Include the name and address of the entity and each securitization the entity rated or was asked to rate.

Included in Appendix 3 are the rating agencies' original and current ratings of Goldman Sachs securitizations. The rating agencies names and addresses are included in Appendix 4.

You also ask us to identify entities that were "asked to rate" the securitizations identified in question 3. We have never tracked this type of information and, therefore, have no basis upon which to provide a response to that question.

5.(a) Please provide a list of all warehouse lines or other funding Goldman provided to any mortgage originator from January 2001 to the present that includes the date of the warehouse line, the entity that received the warehouse line, the balance of the warehouse line at the end of each quarter and the number and (b.) dollar amount of loans originated by the entity and (c.) the number and dollar amount of the loans acquired by Goldman from the entity.

a. We began providing warehouse funding to residential mortgage originators in 2003. Accordingly, Appendix 5a includes a list of all of our warehouse lines to originators of residential mortgage loans from May 2003 to the present. We have provided the date of the warehouse line and the balance of each line as at the end of each fiscal quarter.

b. You have requested a list of the number and dollar amount of loans originated by the entities to which we provided warehouse financing. As these entities are unrelated to Goldman Sachs, we do not have access to this information and are therefore unable to provide it.

c. Appendix 5c contains a list of all loans that we acquired from the counterparties to our residential mortgage warehouse facilities.

7. List all Goldman officers responsible for due diligence, or supervising third party due diligence firms, with respect to Goldman Securitizations identifying the deal on which they exercised responsibility from January 1, 2006 to December 31, 2009.

Christopher Gething managed the group that was responsible for conducting due diligence on Goldman Sachs' residential mortgage whole loan purchases and securitizations, including general supervision of the individual team members' interaction with third party due diligence providers during that process.

8. Please explain Goldman's due diligence practices or disclosures to investors regarding mortgage loans originated, acquired, securitized or sold, including any changes to those practices and disclosures, following the September 2004 warning from the FBI about mortgage fraud.

In our March 1, 2010 letter to Chairman Angelides (see Appendix 8), we describe our due diligence practices and the disclosures set forth in offering documents.

11. Please provide a written copy of any written statement (or a transcript of any recorded statement made by a client of Goldman in a recorded telephone conversation) made by any counterparty to Goldman or client of Goldman, with respect to any transaction listed in question 2.

It is not clear which transactions are being referred to, as there are no transactions listed in question 2. However, we do not record telephone conversations in the product areas that have been the subject of the inquiries contained in the FCIC's letters to us of January 28 and February 3, 2010.

12. Please list any Goldman off balance sheet accounts between January 1, 2006 and December 31, 2009. Did Goldman ever subsequently report any off balance sheet account on its balance sheet? If yes, please explain when and why.

As detailed in our Form 10-K and 10-Q filings, the firm has off-balance sheet accounts in the form of non-consolidated variable interest entities (VIEs) in which the firm holds financial interests. The relevant extracts from our Form 10-Ks and 10-Qs for 2006, 2007, 2008 and 2009 are attached as Appendix 12.

We do not have off-balance sheet commitments to purchase or finance any CDOs held by structured investment vehicles.

As described in our financial statements, we consolidate entities in which we have a controlling financial interest. As required by U.S. GAAP (Accounting Standards Codification 810) applicable through December 2009, we consolidated a VIE whenever we absorbed a majority of the VIE's expected losses, received a majority of the VIE's expected residual returns, or both. As required by U.S. GAAP, we also reassess our initial evaluation of a VIE upon the occurrence of certain reconsideration events as outlined in ASC 810. During the period from 2006 to 2009, the amount of VIE assets that the firm consolidated due to reconsideration events that had previously been disclosed as non-consolidated (off-balance sheet) VIEs was immaterial, and was driven by the firm acquiring additional financial interests in the VIE at then current market prices. There was no impact to our income statement, because the purchase of additional financial interests that led to the consolidation was at then-current market prices, and because all of our trading assets are marked to market.

13. Please list all transactions between March 1, 2008 and March 17, 2008 in which Goldman established or maintained a financial position for its own proprietary trading account (or account of any hedge fund or other entity in which Goldman, or any member of the senior management committee, had a direct or indirect financial interest, but excluding accounts for third party clients of the firm) whether directly or indirectly, equivalent to shorting a security, or establishing a put position with respect to a security, or purchasing a credit default swap regarding any security issued by Bear Stearns.

The volume of activity for the firm's proprietary trading accounts in securities issued by Bear Stearns or credit default swaps referencing that company during the period from March 1, 2008 to March 17, 2008 was insignificant. The net impact of these transactions was less than \$10 million, and our resulting residual position was a net short exposure of less than \$5 million.

Total net activity for those funds or accounts managed by Goldman Sachs Asset Management in which the firm and/or any member of the senior management committee has a financial interest amounted to less than \$30 million, and the resulting residual position in the funds or accounts was a net long of approximately \$25 million as of March 17, 2008. These amounts represent aggregate fund level information, and accordingly the firm's and/or senior management committee members' interest in any given investment vehicle is a fraction of the totals.

Goldman Sachs does not direct, nor does it have detailed information with respect to, the investing activity of third party hedge funds or similar third party investing vehicles that the firm or any member of the senior management committee may invest in and as such, any transactions these third party vehicles may have entered into are not included within the data provided.

14. Please list all transactions between September 1, 2008 and September 15, 2008 in which Goldman established or maintained a financial position for its own proprietary trading account (or account of any hedge fund or other entity in which Goldman, or any member of the senior management committee, had a direct or indirect financial interest, but excluding accounts for third party clients of the firm), whether directly or indirectly, equivalent to shorting a security, or establishing a put position with respect to a security, or purchasing a credit default swap regarding any security issued by Lehman.

The volume of activity for the firm's proprietary trading accounts in securities issued by Lehman Brothers or credit default swaps referencing that company during the period from September 1, 2008 to September 15, 2008 was insignificant. The net impact of these transactions was approximately \$30 million, and our resulting residual position was a net long exposure of approximately \$20 million.

Total net activity for those funds or accounts managed by Goldman Sachs Asset Management in which the firm and/or any member of the senior management committee has a financial interest amounted to approximately \$40 million, and the resulting residual position in the funds or accounts was a net long of approximately \$5 million as of September 15, 2008. These amounts represent aggregate fund level information, and accordingly the firm's and/or senior management committee members' interest in any given investment vehicle is a fraction of the totals. Goldman Sachs does not direct, nor does it have detailed information with respect to, the investing activity of third party hedge funds or similar third party investing vehicles that the firm or any member of the senior management committee may invest in and as such, any transactions these third party vehicles may have entered into are not included within the data provided.

15. When responding to the question about whether Goldman's risk management was sufficient to allow Goldman to survive but for government assistance, you testified that you wished Goldman was less leveraged in 2008. You also testified that the high water mark of Goldman's leverage was about 20 to 1. In response to a question later in the hearing, you testified that the high water mark of Goldman's leverage was in the mid-20s. Please provide the support for that testimony. Please provide all measures of Goldman's leverage at the end of each quarter from 1Q01 through 4Q09 and explain how each leverage measure is calculated.

There are two primary measures commonly referred to as "leverage ratios":

- 1) A calculation of total assets divided by total shareholders' equity, and

- 2) A calculation of “adjusted assets” (which excludes low-risk assets) divided by tangible equity capital.¹

The second measure is referred to as the “adjusted leverage ratio” and it is a more meaningful measure for financial institutions because it adjusts for the nature of the assets being held. “Adjusted assets” excludes (i) low-risk collateralized assets generally associated with matched book and securities lending businesses, (ii) cash and securities we segregate for regulatory and other purposes and (iii) goodwill and identifiable intangible assets (which are also excluded from the tangible equity capital). The first measure, by contrast, makes no distinction between low risk assets and other assets with greater risk. Accordingly, adjusted leverage avoids the counterintuitive result of an institutions’ leverage deteriorating due to an increase in excess liquidity that is invested in low-risk collateralized assets.

The leverage ratios and adjusted leverage ratios for Goldman Sachs for all the periods requested from 2001 to 2009 are included in Appendix 15.

16. When responding to the question about whether Goldman’s risk management was sufficient to allow Goldman to survive but for government assistance, you also cited the fact that Goldman raised \$5.75 billion of capital from Warren Buffett as evidence that Goldman had access to private capital and was not relying on government assistance. Did you or anyone at Goldman have any discussions with Mr. Buffett concerning his investment in Goldman that related to whether the government might be providing assistance to Goldman? If yes, please provide the details of those discussions.

We do not know of any such discussions.

18.(a) Please describe how Goldman’s board of directors, committees of the board of directors, internal auditors, outside auditors and regulators review, test and audit the company’s risk management practices, including the value of Goldman’s assets and its leverage.

(b) At any point during or after 2007, did any of those entities, or any other entities, express any concern or raise any issues about the value or quality of Goldman’s assets or of the bank’s leverage? If yes, what were those concerns or issues, when were they raised and how did Goldman respond?

a. We believe that effective risk management is critical to the success of the firm, and is the primary reason why we were able to avoid the substantial losses suffered by many of our competitors in 2007, 2008 and 2009. We employ a comprehensive risk management framework that includes oversight and governance by the Board of Directors (the “Board”), a series of firmwide committees and several independent control functions. Management conducts quarterly

¹ Tangible equity capital equals total shareholders’ equity and junior subordinated debt issued to trusts less goodwill and identifiable intangible assets. We consider junior subordinated debt issued to trusts to be a component of our tangible equity capital base due to certain characteristics of the debt, including its long-term nature, our ability to defer payments due on the debt and the subordinated nature of the debt in our capital structure.

self-assessments of key controls and independent assessments by internal auditors, external auditors and various regulators are regularly performed, as discussed below.

The Board establishes the strategic direction of the firm and oversees the performance of the firm's business and management. Through its various committees, it sets corporate governance mandates, compensation policies and reviews the firm's financial and operational results. Primarily through the Audit Committee, whose members include all but one of our Board's non-employee directors, the Board also oversees the firmwide risk management governance bodies, including those related to market, credit, liquidity and other financial and operational risks. Underlying many of these processes is a focus also on reputational risk. The Audit Committee regularly receives, reviews and discusses with management detailed presentations and analysis on our aggregate risk exposures, including market, credit, liquidity and other financial and operational risks. In the course of these reviews, the Audit Committee interacts on a frequent basis with the Chief Risk Officer, as well as with other key risk management executives from both the independent control functions and the revenue-producing units of the firm. In addition, the Audit Committee receives regular reports from both Internal Audit and PricewaterhouseCoopers LLP ("PwC"), the firm's external auditor as part of their annual audit.

Goldman Sachs has established several cross-functional risk oversight committees composed of senior members from both revenue-producing units and independent control functions, including the Management Committee, Firmwide Risk Committee, Securities Division Risk Committee, Investment Management Division Risk Committee, Business Practices Committee, Firmwide Capital Committee, Commitments Committee, Credit Policy Committee, Finance Committee, New Products Committee, Operational Risk Committee and Structured Products Committee. These committees meet regularly and, by design, have overlapping risk management mandates and responsibilities across the firm. The committee structure is global in nature and is supplemented by divisional and regional sub-committees, which provide additional oversight and monitoring of market and reputational risk. In addition, certain legal entities have entity-specific oversight committees.

Our control functions (e.g., Compliance, Controllers, Risk, and Operations) are independent of the revenue-producing units and are critical to the risk management process. These control functions perform daily transactional and positional reviews and produce risk management metrics that are disseminated to key risk managers on a daily basis. The Controllers function performs frequent price verification procedures to ensure that the valuation of assets is accurate.

Goldman Sachs executes a quarterly self-assessment and certification process to evaluate the design and operational effectiveness of key controls across all revenue producing and control functions, as required by Section 404 of the Sarbanes-Oxley Act of 2002. The self-assessment process includes both financial reporting controls as well as other operational controls related to risk management. Results of management's self-assessments are provided to the Audit Committee annually in support of the filing of the firm's financial statements.

Our internal auditors, external auditors and regulators regularly review, test and audit our risk management processes, including the valuation of our assets, as detailed below:

- a) Internal Audit is an integral part of the firm's risk management infrastructure. As an independent function within the firm, with a direct reporting line to the Board's Audit Committee, Internal Audit provides opinions and recommendations on the internal control structure and thereby supports the Audit Committee in fulfilling its oversight responsibility. Internal Audit comprises many of our most experienced people. It conducts regular reviews of the firmwide risk management governance bodies, including the Firmwide Risk Committee and the Finance Committee, which oversee the firm's risk positions and balance sheet, and establish liquidity policy. In addition, through its audits of the various risk management functions including market risk, credit risk, operational risk and liquidity risk management, Internal Audit provides assurance as to the adequacy of design and effectiveness of execution of the controls within these functions. Specifically, Internal Audit undertakes audits of the processes and systems management has put in place related to price verification and valuation of assets. Additionally, Internal Audit tests the completeness and adequacy of management's quarterly Section 404-related self-assessments as part of its audits of specific areas. The results of these reviews are provided to the Audit Committee.
- b) Our external auditor, PwC, conducts its audits in accordance with the auditing standards established by the Public Company Accountability Oversight Board, which are designed to obtain reasonable assurance about the fair presentation of the financial statements (which includes the valuation of our assets) in accordance with generally accepted accounting principles. Testing performed throughout the year, together with an evaluation of the design and operating effectiveness of internal controls over financial reporting and such other procedures as they consider necessary enable PwC to provide an opinion on the effectiveness of the firm's internal controls over financial reporting. PwC is also required to discuss with the Audit Committee its judgment about the quality of the application of our accounting principles and the clarity and completeness of our financial statements, including related disclosures. Such accounting principles include the application of fair value measurements and the resulting valuation of our assets.

The Federal Reserve is responsible for the firm's consolidated prudential supervision. Its mandate includes ensuring the safety and soundness of the nation's banking and financial system. Goldman Sachs and its subsidiaries are further subject to extensive oversight by other regulatory bodies in the United States and around the world, of which the primary examples are the:

- Securities and Exchange Commission, within which the Division of Trading and Markets establishes and maintains standards for fair, orderly and efficient markets, and which is the primary regulator of our major U.S. broker-dealer subsidiary, GS&Co. and certain other entities

- Financial Services Authority (FSA) in the United Kingdom, which oversees all of our regulated subsidiaries in the UK, including our large broker-dealer subsidiary, Goldman Sachs International. The primary objectives of the FSA include maintaining confidence in the financial system and ensuring the appropriate degree of protection for consumers
- Financial Services Agency in Japan, which oversees our Japanese broker-dealer subsidiary, Goldman Sachs Japan Co., Ltd.

Additionally, Goldman Sachs is supervised by various regulators throughout the world which are primarily focused on ensuring the effective operation of the financial markets within their jurisdictions. These regulators include:

- Federal Deposit Insurance Corporation, New York State Banking Department, Office of the Comptroller of the Currency, U.S. Commodity Futures Trading Commission, Chicago Board of Trade, Financial Industry Regulatory Authority and the National Futures Association in the United States;
- Irish Financial Services Regulatory Authority in Ireland;
- Federal Financial Supervisory Authority (BaFin) and the Bundesbank in Germany;
- Autorité de Contrôle Prudentiel in France;
- Banca d'Italia and the Commissione Nazionale per le Società e la Borsa (CONSOB) in Italy;
- Federal Financial Markets Service in Russia;
- Swiss Financial Market Supervisory Authority (FINMA);
- Securities and Futures Commission in Hong Kong;
- Monetary Authority of Singapore;
- Korean Financial Supervisory Service;
- Reserve Bank of India and the Securities and Exchange Board of India;
- Central Bank of Brazil; and
- Investment Industry Regulatory Organization of Canada.

As part of their supervisory activities, these regulatory bodies continuously monitor the entities under their supervision. They generally engage in a variety of oversight activities, such as on-site testing, and reviews of our risk management, price verification and Internal Audit functions.

b. We regularly discuss the valuation of our assets and our liquidity metrics with various of the parties listed in your question and did so continuously throughout 2007 and 2008, particularly as conditions worsened. Management frequently explained the actions it was taking to improve available pricing on level 3 assets in the fair value hierarchy, to reduce illiquid inventory and increase liquidity. We are not aware of concerns being raised as a result of these discussions by the board of directors, internal auditors or regulators. Our external auditors, PwC, expressed unqualified opinions on the fair presentation of our financial statements and did not propose any adjustments to the financial statements.

19.(a) You testified that there should have been more regulation than there was in September 2008 under the old regime; i.e., under the SEC. Please explain what additional regulation there should have been. (b.) Please describe any changes in regulation since Goldman became a bank holding company and subject to regulation by the Federal Reserve. How is regulation by the Federal Reserve different than regulation by the SEC under the Consolidated Supervisory Entity program?

As a preliminary matter, in Mr. Blankfein's comparison of the former Consolidated Supervised Entity framework administered by the SEC and the current bank holding company framework administered by the Federal Reserve, he drew attention primarily to the fact that the Federal Reserve is more visible as a regulator, since it maintains an on-site team of examination staff who review nearly every aspect of our business. While the Consolidated Supervised Entity regime doubtless was not perfect, many other U.S. and international regulators were also responsible for the supervision of financial institutions that experienced significant difficulties and, in some cases, failure during the financial crisis. It is, therefore, likely that any observations regarding additional regulation that should have been in place apply equally to nearly all prudential regulators across the globe. Specific areas where there could have been additional regulation include the following:

- i) Greater emphasis on liquidity: although there was a widespread recognition among the regulatory community that capital requirements do little to mitigate liquidity risk, regulators generally did not set binding liquidity metrics. Goldman Sachs had rigorous liquidity guidelines that served us well during the crisis, but these were developed independently and without the prompting of formal regulatory requirements.
- ii) More rigorous application of mark-to-market rules: many firms appear to have been slow to recognize the increasingly alarming implications of higher rates of mortgage defaults in the early days of the financial crisis, mainly because they either did not mark their exposures to market, or they did not apply the mark-to-market accounting convention with the necessary degree of rigor. Regulators should have exerted their influence more strongly to ensure that mark-to-market accounting was applied more consistently. Going forward, the regulatory framework should be adjusted to a full fair value model wherever possible to mitigate such future crises, and financial institutions should be required to have a control infrastructure sufficient to support the accurate application of fair value processes.

iii) Greater emphasis on risk monitoring and management: as the financial crisis started to unfold, it is clear with the benefit of hindsight that many financial institutions, and their regulators, failed to appreciate the nature and extent of the risks to which they were exposed. The specific failures of risk management no doubt vary from firm to firm, but are likely to have included a failure to measure aggregate risk appropriately (and thus to understand how much exposure the institution had), under-resourcing of the risk management groups and insufficiently independent risk management functions. Although certain institutions, including our own, had long accorded a high degree of status, resources and, most importantly, independence to their risk monitoring functions, clearly this was not universally the case.

iv) Greater attention to disputes between firms, particularly to collateral disputes: in retrospect it should have been clear that collateral disputes between firms were an indicator that one of the parties to the dispute may have failed to recognize the reality that the market price of their positions had deviated from the valuation that had been placed upon them internally. This was an available early warning sign for regulators that appears to have gone unheeded.

v) Greater attention to lending standards: the vast majority of the losses incurred by financial institutions during the financial crisis can be traced to bad lending decisions. If financial institutions had been required by their various regulators to maintain consistently high standards in their credit approval processes, it is possible that the worst of the financial crisis could have been averted.

b. There are important differences between the regulatory framework that applied to Goldman Sachs as a Consolidated Supervised Entity prior to September 2008 and the one that has applied to us as a bank holding company since that time. Nevertheless, both regulatory frameworks share two important characteristics: firstly, under both frameworks, all activities of the firm were and are subject to scrutiny by regulators; secondly, all of our financial exposures were and are subject to capital requirements.

Among the most noteworthy differences between the two regulatory frameworks, the following stand out:

- As a bank holding company, we are now subject to a leverage ratio, which was not the case when we were a Consolidated Supervised Entity. However it is important to note that Goldman Sachs generally would have met the bank holding company leverage ratio test since becoming a public company in 1999, and certainly did so in 2008.
- Our capital requirements are now computed using the Basel I framework, whereas we used the Basel II framework as a Consolidated Supervised Entity.
- As a bank holding company (and, now, a financial holding company), we are subject to certain activity restrictions that did not apply to us as a Consolidated Supervised Entity.
- Our business activities are subject to ongoing examination by a substantial team of on-site examiners. In contrast, the SEC did not maintain an on-site team of examiners, but

rather sent in examination teams on a periodic basis to review specific aspects of our business.

We have included as Appendix 19 the regulations to which we were subject as a Consolidated Supervised Entity.

20. In your written testimony you stated that too many institutions outsourced their risk management to credit rating agencies and during the hearing you testified that there were instances where Goldman deferred to the credit rating agencies. For example, you testified that you deferred to the credit rating agencies by being more complacent when a security was rated AAA than if it were rated lower. Did Goldman ever perform an internal analysis of any rating by a credit rating agency and come to a different conclusion about the rating? If yes, please provide the details.

Goldman Sachs uses the views of the credit rating agencies as one of many components in our analysis of companies, structures, counterparts and issuing entities. Our internal credit analysts also conduct their own fundamental analysis. We perform many thousands of such analyses in the course of a year, and it is inevitable that there will be circumstances where our credit views diverge from those of the rating agencies, as well as from those of other investors and analysts. We would also note that in the secondary trading market, there were many thousands of circumstances where the market prices of mortgage-backed securities reflected a deterioration of the underlying credit quality well before the credit ratings agencies had adjusted their ratings.

21. Please answer the questions in the January 12, 2010 New York Times article by Andrew Ross Sorkin, titled "What the Financial Crisis Commission Should Ask."

a. "Mr. Blankfein, your firm, and others, created and sold bundles of mortgages known as collateralized debt obligations that it simultaneously sold short, or bet against. These C.D.O.'s turned out to be bad investments for the people who bought them, but your short bets paid off for Goldman Sachs.

In the process of selling them to institutional investors, however, your firm lobbied ratings agencies to assign them high ratings as solid bets – even as your firm planned on shorting them.

Could you explain how Goldman bet against these C.D.O.'s while simultaneously trying to persuade ratings agencies and investors that they were good investments? Were they designed from the outset to be shorted by Goldman and possibly select clients? And were those clients involved in helping design these transactions? What explicit disclosures did you make to Standard & Poor's and Moody's about your plans to short these instruments? And should we continue to allow transactions in which you're betting against what you're also selling?"

Our March 1, 2010 letter to Chairman Angelides discusses the roles of market-makers and underwriters of securities, and provides a description of how we manage the related risk (see Appendix 8).

b. "This one is for the entire group. All of your firms are involved in some form of proprietary trading, or using your own capital to make financial bets, not unlike hedge funds and other private investors. As the recent crisis has shown, these bets can go catastrophically wrong and endanger the global financial system.

Given that the government sent a clear signal in the crisis that it would not let the biggest firms fail, why should taxpayers guarantee this sort of trading? Why should the government backstop what amounts to giant hedge funds inside the walls of your firms? How is such trading helpful to the broader financial system?"

Proprietary trading had little to do with the financial crisis, and certainly did not endanger the global financial system. Relatively few of the losses that occurred during the financial crisis resulted from proprietary trading. In fact, a research paper published by Goldman Sachs Economic Research on November 30, 2009 indicates that the vast majority of the losses that were incurred by financial institutions during the financial crisis can be traced to bad loans in general, and most of those losses can be traced back to bad real estate loans. A copy of this research paper is included in Appendix 21b. Neither our experience, nor any other evidence we know of, suggests that proprietary trading was the cause of the financial crisis.

Safeguards exist under current U.S. banking law to ensure that retail deposits are not used to fund inappropriate trading activities. We do not believe that "taxpayers guarantee this sort of trading" and we have not managed our firm or this activity with any expectation that proprietary trading is ultimately guaranteed by the taxpayer. We do believe that having the flexibility to commit our capital to proprietary trading activities contributes to greater market efficiency and enhances market liquidity.

c. "A question for all the executives about bonuses: We keep hearing that you plan to pay out billions in bonuses this year. Given that they come out of profits that, to a large degree, seem to be the result of government programs to prop up and stimulate the banking sector, do you think they are deserved, even if they are in stock? And, while we're on the topic, given the market crisis of 2008, were you all overpaid in 2007?"

In 2009, performance across our industry was uneven. We believe our strong relative performance was a function of the quality of our client franchise and our solid financial profile, in addition to generally improving market conditions.

Still, we recognize the broader environment. The firm's 35.8% ratio of compensation and benefits to net revenues was its lowest as a public company. While net revenues in 2009 were only 2% lower than the firm's record net revenues in 2007, total compensation and benefits were 20% lower, representing a reduction of \$4 billion.

In 2007 and 2008, we were committed to reducing certain of our risk exposures at pricing levels that many in the market thought were irrational or temporary. We believe a conservative risk management culture, guided by a disciplined fair value accounting process, is the reason why we have one of the strongest balance sheets in the industry. Unlike many of our competitors, we did

not have a significant write-down of assets in 2007, and in 2008, Goldman Sachs generated a profit of \$2.3 billion. Still, in 2008, the firm's senior executive officers (its CEO, CFO, COO and its Vice-Chairmen) did not receive any discretionary compensation and Participating Managing Director compensation decreased by 77%.

d. "Again, for the group: Over the last year, your firms have actively used the Federal Reserve's discount window to exchange various investments (including C.D.O.'s) for cash. You probably have a better idea than most about what those assets now sitting on the Fed's balance sheet are worth."

Goldman Sachs Bank USA tested its ability as a process matter to use the Federal Reserve's discount window by borrowing less than \$10 million. We did this solely in order to ensure that the necessary procedures were in place and that they worked.

22. Please answer the question in the January 13, 2010 New York Times article titled "Questions for the Big Bankers."

22.a JAMES GRANT

22.a.1 Bankers are dealers in money. The Federal Reserve is a creator of money — since the crisis began in August 2007, it has conjured up \$1.1 trillion. Given the ease with which these dollars are materialized on a computer screen, how can they be worth anything?

This question should be directed to the Federal Reserve. We have no comment on this question.

22.a.2 The Federal Reserve's setting of its benchmark federal funds rate at nearly 1 percent in 2003 to 2004 was a primary cause of the housing and mortgage debacle. Yet, in an attempt to nurse the economy back to health, the Fed has set that rate at nearly zero percent. So what's the next bubble, and how do you intend to profit by it?

Goldman Sachs has no special ability to predict the future and, therefore, cannot reliably identify the form, duration and nature of a future asset bubble. We would also add that bubbles are often conclusively identified only in retrospect, after values have definitively fallen.

22.a.3 For Mr. Blankfein: In capitalism, profits are no sin, yet Goldman Sachs keeps making excuses for its success in 2009. If you earned the money honestly, what are you apologizing for? And if you didn't earn it honestly, how did you do it?

We have made no excuses for our performance in 2009. Improving economic conditions, a strong financial profile and a strong client franchise were the foundations of our relative performance.

Any regrets that we have expressed stem from our wish, like many others in the financial services industry, that we had been better able to predict the causes of the financial crisis and to have been able to react even more quickly as a result.

22.b BETHANY McLEAN

22.b.1 It still isn't clear precisely how mortgage-related losses in the financial sector grew to be many times greater than the actual losses on the mortgages themselves. What role did synthetic collateralized debt obligations — a Wall Street invention that uses credit default swaps to mimic the payments from mortgages — play in multiplying the losses? Is there any way in which a synthetic debt obligation adds value to the real economy?

We do not agree with the premise of this question.

The research paper published by Goldman Sachs Economic Research on November 30, 2009 (included in Appendix 21b) indicates that the vast majority of the losses that financial institutions sustained over the course of the financial crisis can be traced to bad credit decisions in general, and most of those can be traced back to bad real estate loans. Securities like CDOs and associated derivatives embedded what were essentially credit risks emanating from lending decisions.

The process of being able to buy risk from those unwilling or unable to hold it is vital to the effective functioning of financial markets and, by extension, to economies. A properly structured transaction, like a CDO or CDS, facilitates this process. See also our response to question 22.g.2.

22.b.2 Goldman Sachs and other Wall Street firms argue that the clients to whom they sold mortgage-related securities were sophisticated investors who fully understood the risks. Goldman has said this was also the case when its clients bought the very same mortgage securities that Goldman, on its own behalf, was betting would default. Did these clients indeed understand all the gory details?

Our March 1, 2010 letter to Chairman Angelides discusses the information that was available to investors in residential mortgage-related products.

22.b.3 At the height of the panic in the fall of 2008, Wall Street firms blamed short-sellers for trying to destroy them. What short positions did Wall Street firms have in one another's shares, and were they also betting against each other using credit default swaps?

We do not know what proprietary positions other firms held in the equity or debt of other financial institutions. We make markets for our customers, within predefined risk limits, in the equity securities, debt instruments and credit default swaps of other financial institutions. In addition, as highlighted by our responses to questions 13 and 14, Goldman Sachs did not enter into any meaningful net proprietary positions in, or with respect to, either Lehman Brothers or Bear Stearns securities in the weeks preceding their respective bankruptcy and sale.

22.c DAVID STOCKMAN

22.c.1 Without the Troubled Asset Relief Program, Wall Street banks would not have survived the shock to the financial system that occurred in September 2008. Nor would they have subsequently accrued large profits and bonus pools in 2009. Shouldn't a substantial share of those bonus pools be sequestered on bank balance sheets for several years to increase the banks' capital levels and shield taxpayers against another bailout?

We do not agree with the premise of this question.

As to the question, we certainly believe as to Goldman Sachs the answer is no. During 2009, the firm repurchased the \$10 billion preferred stock and associated warrant that was issued to the U.S. Treasury pursuant to the Treasury's TARP Capital Purchase Program. In total, taxpayers received \$318 million in dividends, \$1.1 billion for the warrant repurchase and \$10 billion for the preferred stock, representing an annualized return on the total investment in Goldman Sachs of approximately 23%. Also during 2009, the firm incurred \$6.44 billion of corporate tax expenses, resulting in an effective tax rate of 32.5%.

Our current capital ratios are significantly in excess of required regulatory levels, and we increased our common shareholders' equity by \$31.1 billion, from \$32.7 billion at the end of 2006 to \$63.8 billion at the end of 2009. We currently have one of the highest Tier 1 common ratios in the industry (12.2% as of December 2009 year-end). Further, while our net revenues in 2009 were only 2% lower than our record results in 2007, total compensation and benefits was 20% lower, representing a reduction of \$4 billion.

For 2009, our Management Committee, which is comprised of our top 30 senior executives, received no discretionary cash compensation. The discretionary portion of their compensation was in the form of Shares at Risk which have a five year period during which an enhanced recapture provision will permit the firm to recapture the shares in cases where an employee engaged in materially improper risk analysis or failed sufficiently to raise concerns about risks.

Enhancing our recapture provision is intended to ensure that our employees are accountable for the future impact of their decisions, to reinforce the importance of risk controls to the firm and to make clear that our compensation practices do not reward taking excessive risk.

The enhanced recapture rights build off an existing claw back mechanism which goes well beyond employee acts of fraud or malfeasance and includes any conduct that is detrimental to the firm, including conduct resulting in a material restatement of the financial statements or material financial harm to the firm or one of its business units.

Accordingly, we believe both our compensation and capital levels are entirely appropriate.

22.c.3 Wall Street turbocharged the subprime mortgage boom from 2002 to 2006 by providing billions in cheap warehouse loans to non-bank lenders that otherwise had virtually no capital or financing. Had the Federal Reserve kept short-term interest rates at a more normal 4

percent to 5 percent, rather than pushing them down to 1 percent, would this not have greatly curtailed the reckless growth of subprime loans?

In the context of large, global balances, monetary policy may have played a role in contributing to an environment of easy credit.

22.d LIAQUAT AHAMED

22.d.1 One result of the Pecora commission, the Depression equivalent of this investigation, was the Glass-Steagall Act, which kept investment banking separate from commercial banking until the act was repealed in 1999. Many experts now believe that divide should be reinstated. Yet commercial banks like Washington Mutual lost a lot of money during the crisis without having any investment banking activities, and pure investment banks like Bear Stearns and Lehman Brothers collapsed without being deposit-taking institutions. This suggests that the problem does not lie with mingling commercial and investment banking. Are you in favor of the return of Glass-Steagall, and why?

Goldman Sachs does not advocate the return of Glass-Steagall. The issue at the heart of the crisis was fundamentally poor lending decisions, which had nothing to do with the mingling of commercial and investment banking.

22.d.2 Many people argue that the financial industry now accounts for far too much of the gross domestic product and that it is unproductive, indeed counterproductive, to devote so much of the nation's resources to simply moving money around rather than making things. Why has this shift occurred and what, if anything, can the government do about it?

We do not agree with the premise of this question and do not have an opinion as to why this shift occurred (if it did).

22.e SIMON JOHNSON

22.e.1 Describe in detail the three worst investments your bank made in 2007 and 2008 — that is, those transactions on which you lost the most money. How much did the bank lose in each case?

Goldman Sachs was profitable in both 2007 and 2008. However, during fiscal 2007 and fiscal 2008, as disclosed in our Form 10-Q and 10-K filings, we incurred significant losses from non-investment grade origination activities and residential and commercial mortgages loans and securities, as well as in our Principal Investments business. These losses included:

- Non-investment-grade credit origination activities: In fiscal year 2007 and fiscal year 2008, we incurred losses, net of hedges, of approximately \$1 billion and \$3.1 billion, respectively.

- **Mortgages:** In fiscal year 2008, we incurred net losses of approximately \$1.7 billion on residential mortgage loans and securities and approximately \$1.4 billion on commercial mortgage loans and securities.
- **Principal Investments business:** In fiscal year 2008, we incurred a net loss of \$3.86 billion, including a loss of \$2.53 billion from corporate principal investments, \$949 million from real estate principal investments and \$446 million related to the firm's investment in the ordinary shares of Industrial and Commercial Bank of China Limited.

22.e.2 What was the total compensation of each manager or executive supervising those three transactions — including yourself — in 2007 and 2008?

Significant investment decisions at Goldman Sachs are not made by any one individual, but instead are collaborative decisions, often the subject of various firmwide and divisional committees, or subject to approval and monitoring through the application of specific risk limits. We consider this fact to be a key component of our ability to have avoided significant losses many of our competitors suffered in 2007 and 2008.

Our committee structure is overseen by our CEO and certain other senior officers. The names and compensation of our most senior executive officers are disclosed in our proxy statements for 2007 and 2008, which are included in Appendix 22.e.2.

22.e.3 Are those executives still with your bank? What investments do they supervise today? How much will they be paid for 2009, including their bonuses?

Please see our response to question 22.e.2. The compensation of our CEO in 2009 was a salary of \$600,000 and a bonus (in the form of Shares at Risk) of \$9 million. Other senior officers received a salary of \$600,000 and a bonus of \$9 million as well.

22.f YVES SMITH

Some of your firms received payouts on credit-default swap contracts with American International Group. Most of those guarantees resulted from hedging supposedly safe investments (they had AAA ratings, after all) with A.I.G. or other insurers. This hedging allowed traders to book “profits” that had not yet been earned — profits that would be counted in calculating their bonuses.

However, this insurance was likely to fail, as your risk managers surely knew. It involved so-called wrong-way risk: the guarantor (A.I.G.) was certain to be damaged by the same event (the housing market collapse) that would lead you to seek payment on the insurance. The insurance was effective only because the government stepped in, theoretically on the taxpayers' behalf, and made payments for A.I.G., an otherwise bankrupt firm. Since employees' bonuses, and ultimately yours, were based on these fraudulent profits, my questions are these:

22.f.1 How much profit did your firm record for bonus purposes on these trades that ultimately delivered huge losses? How much of those bogus profits were paid out in bonuses? Have you made any effort to recover the bonuses? If not, why not?

The credit default swap contracts we had with AIG were primarily designed to hedge equivalent transactions executed with clients taking the other side of the same trades. In so doing, we served as an intermediary in assisting our clients to express a defined view on the market, rather than as a proprietary market participant. Therefore, as prices of the underlying securities declined, we provided collateral to clients and called for collateral from AIG. We earned profits commensurate with our role as market intermediary that were immaterial to our results and therefore immaterial to our bonus payments.

At the time we entered into credit default swaps with AIG, AIG was a AAA-rated company and considered among the most sophisticated counterparts in the world. We established credit terms with AIG commensurate with those extended to other major counterparts, including a willingness to transact substantial trading volumes subject to collateral arrangements that were tightly managed. As a result, prior to the Federal Reserve's investment in AIG, we had received from AIG approximately \$7.5 billion in cash collateral which acted as security for the credit default swaps. When AIG disputed our valuations, we took steps to protect ourselves against the possibility that they would not perform on their contracts, principally by buying credit default protection from other major financial institutions. These hedges were collateralized with collateral that we received from these institutions, which we updated on a daily basis. Therefore, the assertion that the credit default swaps purchased from AIG would not have been effective is incorrect.

The assertion that reported profits were fraudulent has no basis in fact. Our response to two newspaper articles regarding our exposure to AIG has been posted to our public website (www.gs.com), and is included in Appendix 22.f.

22.g WILLIAM D. COHAN

22.g.1 Why did Wall Street continue to package and sell as securities so many mortgages of questionable value and underwriting standards even as the housing market started to collapse?

After the fact, it is easy to be convinced that the signs were visible and compelling. In hindsight, events not only look predictable, but also often look like they must have been obvious or known. No one, however, has any special ability to predict the future. In fact, investors and financial institutions held very different views of the future direction of housing prices, interest rates and other factors. Some investors developed aggressively negative views on the mortgage market. Other different investors believed any weakness in mortgage securities and the housing market would be relatively mild and temporary. Most observers did not expect or anticipate that the contraction in the housing market would be as severe as it was, including many of the world's most sophisticated investors.

22.g.2 Why were Wall Street traders and other moneymen permitted to make bets — through the use of so-called credit-default swaps — on the long-term value of securities they didn't even own? (This is akin to everyone in your neighborhood being allowed to buy fire insurance on your house. Since the only way that bet can pay off is if your house burns down, it shouldn't be any surprise when that is exactly what happens.)

We do not agree with the premise of the question or the analogy.

Derivatives, including credit-default swaps (“CDS”), have proven to be a very important tool by which many market participants have been able to manage risk. They have brought more capital into the credit market because investors and intermediaries have been able to hedge their risk more effectively. By and large, the CDS market functioned effectively throughout the crisis.

When a financial institution sells protection through CDS, it generally buys protection through CDS to offset the risk. CDS transactions are marked-to-market and because we and other firms require counterparties to post collateral, actual economic exposure is generally limited before actual settlement.

Clearly, some institutions held highly concentrated CDS positions, suggesting that some market participants were quite slow to recognize the underlying risk and collateral implications of their positions.

22.g.3 Why aren't bankers and traders required to have more skin in the game — that is, more of their own salary at risk — and not just a marginal part of one year's bonus? (In the old days, when investment banks were private partnerships, a partner's entire net worth was on the line, every day.)

At Goldman Sachs, the percentage of compensation awarded in equity increases significantly as an employee's total compensation increases. For our senior people, most of their compensation is in the form of deferred equity-based awards. In fact, for 2009, all of the members of our Management Committee received their entire discretionary compensation in the form of deferred equity-based awards. Senior executive officers are required to retain the bulk of the equity they receive until they retire.

In December, we announced that for 2009 the firm's entire Management Committee would receive 100% of their discretionary compensation in the form of Shares at Risk which have a five year period during which an enhanced recapture provision will permit the firm to recapture the shares in cases where an employee engaged in materially improper risk analysis or failed sufficiently to raise concerns about risks. Enhancing our recapture provision is intended to ensure that our employees are accountable for the future impact of their decisions, to reinforce the importance of risk controls to the firm and to make clear that our compensation practices do not reward taking excessive risk.

The enhanced recapture rights build off an existing claw back mechanism that goes well beyond employee acts of fraud or malfeasance and includes any conduct that is detrimental to the firm,

including conduct resulting in a material restatement of the financial statements or material financial harm to the firm or one of its business units.

22.h DAVID M. WALKER

22.h.1 How did you use the bailout money, and to what extent did it result in more lending or higher bonuses for your employees than you otherwise would have provided?

In both 2008 and 2009, compensation was paid out of the firm's earnings, not its capital. In fact, since the TARP funds were repaid in full in mid-2009, they were certainly not used to pay bonuses. That said, the firm approached its compensation programs for 2009 with a heightened sensitivity to the particular factors and environment surrounding compensation decisions over the current market cycle.

Goldman Sachs serves a number of important roles for its clients, including that of advisor, financier, market-maker, asset manager and co-investor. Our business is institutionally dominated, with the vast majority of its capital commitments made on behalf of corporations, governments, institutional investors (e.g., mutual funds and pension funds) and investing clients (e.g., hedge funds and private equity firms). As a result, Goldman Sachs is largely a "wholesale" institution that is not engaged in traditional commercial banking or direct consumer lending through retail channels.

As a financial institution focused on this wholesale client base, Goldman Sachs actively provided liquidity to institutions during the crisis, helping the capital markets function.

22.h.2 What, if any, changes do you contemplate making to your pay programs for executives and other high-level employees in light of recent events and related public concerns?

Although we believe our historic policies and practices have proven to be effective in setting compensation over time, we have been outspoken about the need to tie compensation to performance. We articulated specific compensation principles, which we presented at our 2009 shareholders' meeting, and have adopted a series of enhancements to our compensation practices consistent with those principles.

These principles are designed to:

- Encourage a real sense of teamwork and communication, binding individual short-term interests to the institution's long-term interests;
- Evaluate performance on a multi-year basis;
- Discourage excessive or concentrated risk taking;
- Allow us to attract and retain proven talent; and

- Align aggregate compensation for the firm with performance over the cycle.

Consistent with our principles, in December, we announced that for 2009 the firm's entire Management Committee would receive 100% of their discretionary compensation in the form of Shares at Risk which have a five year period during which an enhanced recapture provision will permit the firm to recapture the shares in cases where an employee engaged in materially improper risk analysis or failed sufficiently to raise concerns about risks.

Enhancing our recapture provision is intended to ensure that our employees are accountable for the future impact of their decisions, to reinforce the importance of risk controls to the firm and to make clear that our compensation practices do not reward taking excessive risk.

The enhanced recapture rights build off an existing clawback mechanism which goes well beyond employee acts of fraud or malfeasance and includes any conduct that is detrimental to the firm, including conduct resulting in a material restatement of the financial statements or material financial harm to the firm or one of its business units.

Finally, in recent months, we have consulted with many of our largest shareholders on the issue of compensation and specifically the philosophy and structure of compensation. We found an overwhelming consensus that our model has been effective and an important element in producing our strong record of shareholder returns. To further strengthen our dialogue with our shareholders, we announced that they will have an advisory vote ("Say on Pay") on the firm's compensation principles and the compensation of its named executive officers at the firm's Annual Meeting of Shareholders in 2010.

22.h.3 What have you done to modify your risk management and oversight structures to reduce the possibility that the problems of 2008 and 2009 will occur again?

We believe that effective risk management is of critical importance to the success of our firm. The primary reason why we did not incur losses on the scale suffered by many of our competitors in 2008 and 2009 (indeed, we earned profits over the period) is that our fundamental risk management processes, procedures and systems functioned effectively. However, we constantly strive to improve the effectiveness of our risk management, and continue to invest heavily in this area. More specifically, we discovered that there was more systemic vulnerability, contagion and volatility in periods of severe stress than we had anticipated, as well as higher correlations of risks and less liquidity. This has resulted in an increased focus on various types of stress tests as a critical risk management tool.

23. After being asked to reconcile the compensation of Goldman's senior executives in light of where the country is economically (e.g., high unemployment rates, high foreclosures and many people suffering financially), and the fact that accountability was listed as a core value in Goldman's 2007 Annual Report, you testified that Goldman had not announced compensation for 2009 and that compensation always correlated with the results of the firm. Please provide the compensation of Goldman's senior executives in 2009 and comment on the

compensation in light of where the country is economically and the fact that accountability is a core value at Goldman.

Goldman Sachs believes that compensation should be aligned with the firm's financial performance, should motivate proper behavior and should not encourage excessive risk-taking. The firm's historic and current compensation policies and practices have done, and will continue to do, precisely that. A copy of the firm's "Compensation Principles" is included in Appendix 23.

In view of those policies and practices, when Goldman Sachs's performance was significantly down in 2008, the Firm's seven most senior executives requested that the Compensation Committee of the Board of Directors (the "Compensation Committee") not grant them any discretionary bonuses for 2008. The Compensation Committee endorsed that request.

For 2009, the firm's Named Executive Officers (comprising the CEO, CFO and the next three most highly compensated executive officers) received \$600,000 in cash salary and \$9,000,000 in discretionary compensation in the form of restricted stock units ("RSUs") (i.e., they received no discretionary compensation in cash). These amounts were significantly reduced in comparison to 2007, which was a year with comparable financial results. Their RSUs are subject to, among other things, substantial retention requirements, five-year recapture restrictions, and forfeiture under certain circumstances, including improper risk analysis or failure to sufficiently raise concerns about risks. In the same spirit, the firm also voluntarily adopted a shareholder "Say on Pay" vote, which will afford shareholders an advisory vote on the firm's Compensation Principles and the 2009 compensation of its Named Executive Officers at the firm's 2010 Annual Meeting of Shareholders.

In 2009, Goldman Sachs produced net earnings of \$13.39 billion and a 22.5% return on average common shareholders' equity. During the twelve months ended December 31, 2009, book value per common share increased 23% to \$117.48 and tangible book value per share increased 27% to \$108.42.

Further, the firm made a \$500 million contribution to *Goldman Sachs Gives*, our donor-advised fund. The fiscal 2009 compensation for our Participating Managing Directors, including our Named Executive Officers, was reduced by \$500 million to make this contribution.

Goldman Sachs continuously reviews its compensation programs to remain the market leader in setting compensation standards in the financial services industry. To that end, we are actively engaged in dialogue with our various regulators throughout the world about compensation practices, and are evaluating compensation programs in view of regulations recently proposed, including those by the U.S. Federal Reserve and the United Kingdom's Financial Services Authority, as well as the compensation principles recently announced at the summit of the G-20 group of nations. Although we are not subject to the rules set forth by the Special Master for Compensation, we consulted with him regarding the specific details of our compensation structure. Our approach broadly follows, and in many cases is more conservative than, the guidelines he set out. The firm's Compensation Principles can be found in Appendix 23.

25. Please explain what the consequences would have been for Goldman if American International Group (“AIG”) has been allowed to fail. Please list each transaction between Goldman and AIG between January 1, 2006 and December 31, 2008, including any CDS transactions. Include the dates of each transaction, the nature of each transaction, and the amount of collateral posted by AIG, and any transactions by Goldman designed to protect its exposure to AIG. What was the purpose of acquiring CDS from AIG, i.e., were the CDS purchased to hedge against a possible decline in value of assets owned by Goldman, were the CDS purchased to hedge against Goldman’s exposure to another counterparty, or were the CDS purchased for some other purpose? You testified that Goldman had about \$10 billion of exposure but had received about \$7.5 billion in cash from AIG and \$2.5 billion of credit protection. Please provide the supporting documentation related to Goldman’s exposure to AIG.

If AIG had been allowed to fail, our direct exposure to loss was not material. In September 2008, prior to the Federal Reserve’s investment in AIG, we had outstanding credit default swap contracts with AIG which were primarily designed to hedge equivalent transactions executed with clients taking the other side of the same trades. In so doing, we served as an intermediary by assisting clients to express a defined view on the market. The net risk to which we were exposed was consistent with our role as a market intermediary rather than a proprietary market participant. The notional amount of these swap contracts was approximately \$22 billion, of which approximately \$20 billion was against an underlying portfolio of super senior CDOs.

We had established credit terms with AIG which included collateral arrangements. To the extent collateral received did not sufficiently limit our overall credit exposure, we utilized market hedges, including credit default swaps, to keep our overall risk to a manageable level. Prior to the Federal Reserve’s investment in that company, we had gross credit exposure (i.e., before collateral and hedges) of approximately \$10 billion to AIG; this predominantly consisted of exposures to AIG Financial Products Corp. and its affiliates. Against this, we held approximately \$7.5 billion in cash collateral. The rest of our exposure was fully hedged through credit default swaps and other financial products, on which we would have collected if AIG failed to meet its obligations when they fell due (i.e., in the event of default). These hedges were purchased from other major financial institutions with whom we also had collateral requirements in place, and from whom we had regularly exchanged collateral.

While our direct economic exposure to AIG was minimal, the financial markets, and, as a result, Goldman Sachs and every other financial institution and company, benefited from the continued viability of AIG. Although it is difficult to determine what the exact systemic implications would have been had AIG failed, it would have been extremely disruptive to the world’s already turbulent financial markets.

Our primary exposure with AIG was in the form of credit derivative protection purchased by Goldman Sachs International (“GSI”). We have provided the following in Appendix 25:

- The collateral statement sent on September 15, 2008 from GSI to AIG Financial Products. Additionally, we have provided a schedule detailing the collateral movements between GSI and AIG Financial Products, and between Goldman Sachs Capital Markets (“GSCM”) and AIG Financial Products from the beginning of 2007 through 2008.
- For the transactional detail, we have provided a list of credit derivative swap protection purchased from AIG Financial Products by GSI and GSCM on super senior CDO and CMBS underliers. These trades resulted in the collection of the majority of the collateral we received. Substantially all of the collateral disputes between the firm and AIG Financial Products centered around the super senior CDO transactions. We have separately highlighted the super senior CDO positions which were terminated as a part of the Maiden Lane III transaction. We have also provided a schedule of all mortgage related bonds traded between AIG and Goldman Sachs including cash bonds ultimately delivered to Maiden Lane III as required by the Federal Reserve.
- Immediately prior to the Federal Reserve’s investment in AIG and the Maiden Lane III transaction, the composition of our credit hedges relating to our uncollateralized exposure to AIG was almost exclusively comprised of CDS on AIG and AIG cash bonds. Accordingly, we have included a detailed listing of those transactions.

Responses to newspaper articles regarding our exposure to AIG have been posted to our public website (www.gs.com) and have been included in Appendix 22f.

27. Please provide the following information about your institution’s business as an over-the-counter derivatives dealer during each of the last four years, 2006 – 2009:

- Revenues relating to the business;***
- Profits or losses relating to the business;***
- Percentage of the business that consisted of standardized contracts as opposed to customized contracts. Please describe how you are defining “standardized” and “customized” and,***
- Positions held in all OTC derivatives contracts in notional amount at the end of each of the last four years, and positions held in each of the following categories at that time: interest rate, currency, energy, credit, and other.***

a) and b) Although derivative trading is an important part of our business and a core service that we provide to our customers, because of the integrated nature of our trading businesses, it is not practical for us to divide revenues or profitability amongst derivative and non-derivative products, and we do not track or report our financial results in that way.

c) Over the last several years, the percentage of our derivative activity conducted in “standardized” form has continued to increase. Currently, greater than 90% of the derivative

contracts for our interest rate, foreign exchange and credit businesses are executed in “standardized form.” Our definition of “standardized” is that the contract qualifies for legally enforceable electronic confirmation, which is the working definition used in discussions with the Federal Reserve.

d) Appendix 27d contains details of positions held in over-the-counter (“OTC”) derivatives contracts in notional amount at the end of each of the last four years, and positions held in each of the following categories: interest rate, currency, credit, equities and commodities and other derivatives.

28. Please provide the following information about your institution’s proprietary trading during each of the last four years, 2006 – 2009:

- a. Describe the nature and kinds of proprietary trading your institution engaged in;**
- b. The amount of proprietary trading that was speculative and the amount of such trading that was hedging your business risk;**
- c. Revenues relating to proprietary trading;**
- d. Profits or losses relating to proprietary trading and**
- e. Assets held relating to proprietary trading at the end of each of the last four years.**

Goldman Sachs has certain business units which solely engage in proprietary trading activities and are not customer facilitation in nature. These business units are principal equity strategies, credit principal investing and macro proprietary trading businesses. We do not use these businesses for hedging activity.

In Appendix 28, we give details of these activities for the years 2006 through 2009 as requested.

30. Why did Goldman increase leverage after 2004, when it was subject to regulation by the SEC? In 2004, the SEC permitted the broker-dealer subsidiaries to change the way they calculated their net capital. Some believe that this allowed the investment banks to increase their leverage. Please provide data on this question, including the net capital of Goldman’s subsidiary before and after the change in net capital regulation, and the way in which such a change could have increased the leverage of the parent company.

Prior to becoming a Consolidated Supervised Entity in April 2005, a limited number of subsidiaries within the Goldman Sachs group were subject to regulatory capital requirements. For example, our principal U.S. and U.K. broker-dealers were both subject to the capital requirements set by the SEC and the Financial Services Authority in the U.K., respectively. However, other subsidiaries were not subject to regulatory capital requirements. Also, at the consolidated level, we were not subject to specific regulatory capital requirements or leverage ratio restrictions during this time.

For Goldman Sachs, there were two major consequences of our becoming a Consolidated Supervised Entity in April 2005: first, we became subject to regulatory capital requirements at the consolidated level; second, all of our activities (whether carried out in a regulated or an unregulated entity) became subject to oversight and scrutiny by our consolidated regulator, the SEC. In addition, our principal U.S. broker-dealer subsidiary (GS&Co.) became subject to capital requirements which were largely based on VaR models, with supplemental capital requirements designed to capture risks that were not easily captured in VaR. This new methodology was broadly consistent with the Federal Reserve's capital requirements for trading book assets held in banking institutions, and resulted in somewhat lower capital requirements for GS&Co. However, this benefit was greatly outweighed by the additional requirement for capital in all our businesses at the consolidated level.

A summary of GS&Co.'s Net Capital computation from fiscal year-end 2004 (i.e., shortly before adoption of the Consolidated Supervised Entity framework) to 2009, together with a summarized Balance Sheet for these dates is included in Appendix 30. This summary demonstrates that GS&Co's capital requirements fell slightly between fiscal year-ends 2004 and 2005 (from \$10.5 billion to \$9.2 billion). However, this benefit was dwarfed by the new capital requirements that we then incurred at the consolidated level (approximately \$20 billion at fiscal year-end 2005). Consequently, our becoming a Consolidated Supervised Entity was not the cause of increased leverage at the parent company.

31. Assuming that an increase in leverage represents an increase in risk-taking, please explain why in your view Goldman increased its risk-taking after 2004.

The premise that an increase in leverage indicates an increase in risk-taking is certainly not accurate in a variety of circumstances, because the standard leverage ratio² takes no account of the relative riskiness of the assets on the balance sheet. For example, the leverage ratio does not differentiate between a \$100 million position in U.S. Treasuries and a \$100 million position in a CDO-squared security. Even more strikingly, pools of excess liquidity in the form of cash and unencumbered, highly-liquid securities that firms have set aside in order to reduce their liquidity risk are treated equally under the leverage ratio test as the most risky lending exposure. For example, when Goldman Sachs increased its excess liquidity in light of the more uncertain financial environment during 2008, this had the effect of adding to its leverage, even though quite obviously such increases were a prudent step.

Although the "adjusted leverage ratio" is a substantial improvement on the standard leverage ratio, a much better indicator of the relative riskiness of our balance sheet is the Tier 1 capital ratio, which assigns different risk weightings to different asset classes based upon their relative level of risk. Our Tier 1 capital ratios (computed under Basel 2) remained consistently in excess of required levels throughout this period, compared favorably to both our domestic and international competitors and very comfortably met the Federal Reserve's "well capitalized"

² By this, we refer to balance sheet assets divided by shareholders' equity.

standard. Our current Tier 1 capital ratio, computed under Basel I, continues to compare favorably to those of other major financial institutions.

33. Did Goldman acquire subprime mortgages, create pools of these mortgages and sell securities backed by these pools? If so, (i) please provide data on the value of securities sold, (ii) whether Goldman retained any interest in these pools, and (iii) the nature of these interests and their respective dollar amounts.

Beginning in 2002, the firm sold subprime mortgage-backed securities created through the securitization of subprime mortgage loan pools. Typically, these subprime mortgage loan pools were acquired from large mortgage originators for the purpose of securitization. Amounts securitized in each year were approximately as follows: \$4.8 billion in 2002; \$3.0 billion in 2003; \$9.6 billion in 2004; \$13.5 billion in 2005; \$24.4 billion in 2006; and \$7.0 billion in 2007.

In conjunction with these securitizations, we generally retained the subordinated and / or residual securities issued by the securitization vehicle. Although smaller in notional size, these tended to be risky first loss positions issued by the structure. Additionally, we may have retained senior securities and mortgage servicing rights. Amounts retained from each year's issuance were as follows: \$0.5 billion in 2002; \$0.5 billion in 2003; \$1.3 billion in 2004; \$1.3 billion in 2005; \$1.2 billion in 2006; and \$0.1 billion in 2007.

34. Did Goldman engage in rating-shopping – that is, restructuring the pools of mortgages according to the specifications of rating agencies?

For purposes of clarification, we understand your use of the words “rating shopping” to refer to the common market practice of structuring residential mortgage securitizations based on guidance and information from the rating agencies (this clarification is required because we have never heard these words used to describe that activity).

In the past, rating agencies published information on the criteria they used in their models to analyze residential mortgage securitizations. Similar to other firms, Goldman Sachs used its own models (which were based on rating agency criteria) to structure transactions, which were then submitted (together with the supporting legal documentation) to the rating agencies for review. The transaction documents that were submitted to the rating agencies described cash flows, triggers and other features of each transaction, as well as a summary of due diligence results where requested. The rating agencies also reviewed loan tapes and the ratings on bonds that were included as collateral. They then conducted their own analysis and developed tentative ratings for the proposed transaction. The structure of the transaction could be modified based on discussions with the rating agencies, and on certain occasions the rating agencies expressed views as to the sizing of some or all of the classes of securities based on their analysis and published standards.

It was common to request ratings from multiple agencies on a particular deal, as many institutional clients that purchased RMBS required the deals they purchased to be rated by at least two of the rating agencies (and, in some cases, clients may have specifically required a

named rating agency). The vast majority of our deals had ratings from two of the top three credit rating agencies.

35. When did Goldman first become aware of the deterioration of value in subprime mortgages, and was any decision made at that time to reduce Goldman's holdings or to purchase credit default swap coverage for the mortgage-backed securities Goldman then held?

We refer you to our March 1, 2010 letter to Chairman Angelides (see Appendix 8).

36. Since the repeal of the affiliation provisions of Glass-Steagall, and until financial crisis of 2008, the five large investment banks grew much faster than the commercial banks. Why did Goldman?

Goldman Sachs did not grow much faster than the commercial banks. The indirect impact of the repeal of the affiliation provisions of the Glass-Steagall Act was to intensify the competitive environment in which we operated, and in response to client expectations, we began to expand the range of financial services that we provided to our clients accordingly. However, this growth was measured during the period from 2000 to 2008 and in comparison to the major commercial banks, we remain a small company. For example, the number of our total staff (including employees, consultants and temporary staff) grew from 26,800 at fiscal year-end 2000 to 34,500 at fiscal year-end 2008, or an average annual increase of just over 3% per year. This compares to growth and absolute numbers of employees at certain commercial banks over the same period of 11% per year to 224,961 (JPM) and 7% per year to 240,202 (BAC), although it should be recognized that these institutions generally grew through acquisitions to a greater degree than Goldman Sachs. Our balance sheet did grow significantly during the period from 2000 to 2008 (from \$284 billion at year-end 2000 to \$885 billion at the end of 2008), but this growth represents an average annual increase of 15% that was comparable to the rate of growth at our major commercial banking competitors (e.g., 15% at JPM and 14% at BAC). It should also be noted that our shareholders' equity grew at a faster pace than our balance sheet during this period (from \$16.5 billion in 2000 to \$64.4 billion at fiscal year-end 2008, which represents an average annual increase of 19% at fiscal year-end). Further, we believe our conservative risk management practices remained extremely effective as we grew, and as a result we were able to avoid the substantial losses suffered by many of our competitors during the financial crisis.

37. Is there a competitive market for the services of traders in financial instruments, and does that account fully for their compensation levels? If so, does Goldman expect that it will lose the services of these traders with the institution of its new compensation policies? If not, why not?

There is a competitive market for traders in financial instruments. We constantly compete for talent and the market prices that talent. In recent years, we have competed not only with other financial institutions but also with hedge funds and private equity firms to retain many of our people. As a result, compensation across the industry has increased. We must compete for the most valuable people, and we continue to lose talent to other institutions for reasons of

compensation, including offers of multi-year guaranteed contracts, which we have a long-standing policy of declining to offer.

As to our compensation policies, we strongly believe that both our historic and current compensation policies, including our recently issued Compensation Principles (included in Appendix 23), have aligned individual compensation with the Firm's financial performance, motivated proper behavior and discouraged excessive risk taking. In that same spirit, the Firm also voluntarily adopted a shareholder "Say on Pay" vote, which will afford shareholders an advisory vote on those Compensation Principles at the 2010 Annual Meeting of Shareholders.

We consistently review our compensation programs and are actively engaged in a dialogue with our various regulators throughout the world about compensation practices and are continuing to evaluate our compensation programs in light of regulations recently proposed, including those by the U.S. Federal Reserve, requirements of the United Kingdom's Financial Services Authority, and the compensation principles recently announced at the summit of the G-20 group of nations.

38. Many people have argued that Goldman and other investment banks would have been more prudently managed if it had remained a partnership. Do you think this is true, and if so what are the economic or financial benefits to society at large of allowing investment banks to become public companies?

We believe strongly our long standing culture (characterized by conservative risk management, strong teamwork and dedication to client service), originally developed when we were a partnership but continually enhanced and strengthened since becoming a public company, has been strongly validated by the financial crisis. Becoming a public company has not detracted in any way from our ability to prudently and effectively manage our firm. In fact, it has made us a stronger firm through access to permanent capital and the public debt markets.

As to the benefits of allowing investment banks to become public companies: the needs of governments and corporations have evolved over many years, and in today's global economy, our clients require assistance in fulfilling their strategy that smaller institutions simply cannot satisfy.

39. Goldman's leverage for the first three quarters 2009 was 13.5 (total assets divided by shareholders equity), the lowest in 13 years, yet 2009 looks like it will be one of the firm's most profitable years. What accounts for Goldman's ability to earn high profits with low leverage?

The continued profitability of Goldman Sachs during 2009 in spite of historically low leverage levels, bears out our contention that the leverage ratio is largely irrelevant to a consideration of the risk profile or profitability of an institution such as ours.

Our ability to earn high profits during 2009, in spite of both a challenged operating environment and a significantly reduced balance sheet, demonstrates that our business is essentially client-driven. During 2009, we remained committed to serving our clients as an adviser, financier, market-maker, asset manager and co-investor during a period when many of our traditional

competitors retreated from the marketplace, either due to financial distress, mergers or a shift in strategic priorities.

We further attribute our success in 2009 to our focus on risk management. At the start of 2009, our legacy risk positions (such as leveraged loans, and residential and commercial real estate) were at very low levels compared to our capital base, and were prudently and realistically valued. As a result, there was no financial impediment to our taking advantage of risk reducing opportunities when they arose, because all embedded losses had already been absorbed in our income statement.

40. When did Goldman first discuss with the Fed becoming a bank holding company?

For at least a decade, perhaps dating back to the passage of the Financial Services Modernization Act in 1999, Goldman Sachs has reviewed the possibility of our becoming a bank holding company in the context of our overall business strategy. At various times during that period, we believe that there would have been some discussion with the Fed related to that possibility, but we are unable to identify the timing of any such discussion.

As you no doubt are aware, around the time of the acquisition of Bear Stearns by JP Morgan in March 2008, the Federal Reserve Bank of New York increased its level of interaction with Goldman Sachs and other SEC-regulated Consolidated Supervised Entity firms and placed FRBNY personnel within such firms to review their funding and liquidity. After the bankruptcy of Lehman Brothers and the announced acquisition of Merrill Lynch by the Bank of America in September 2008, it appeared very unlikely that the Consolidated Supervised Entity framework administered by the SEC would be continued. Becoming a bank holding company, subject to consolidated regulation by the Federal Reserve, seemed both inevitable, and timely. See our response to question 41.

41. Could Goldman have survived the financial crisis without government assistance? If so, why did Goldman become a BHC?

We are confident that we could have managed our own direct risk without government assistance, but we do not believe any financial institution could have survived a general market failure and financial system collapse. It was impossible to know at that time whether, absent some type of government initiative, markets were headed for widespread collapse, but we were appreciative of the government's intervention. And so, we remain grateful for the actions the government took on behalf of the system. Goldman Sachs benefitted from the general intervention of the government and we think it is appropriate that taxpayers received a 23% annualized return (\$1.4 billion) on their 9-month investment in our firm, which has been fully repaid.

We became a bank holding company because of the importance that the market was assigning to oversight by the Federal Reserve, and because it seemed clear that the Consolidated Supervised Entity framework administered by the SEC would not remain in effect for just two firms.

42. It is said that CDS obligations are not visible on the balance sheets or financial statements of participants in the CDS market. If these obligations are visible to investors and creditors in your financial statements, please identify where they appear and how they are calculated.

Credit derivatives are reflected in the firm's statement of financial condition within "trading assets, at fair value" and "trading liabilities, at fair value" and are fully disclosed in our Form 10-Q and 10-K filings. These disclosures are included in Appendix 42. The disclosures include:

- An overview of the methodologies used to measure the fair value of financial instruments, including credit derivative contracts;
- The fair value of credit derivative assets and credit derivative liabilities included within level 2 and level 3 of the fair value hierarchy;
- Gross fair value values and number of contracts for credit derivatives;
- An overview of the various types of credit derivatives the firm enters into;
- Maximum payout/notional amounts by tenor and carrying value of our written credit derivatives, as well as maximum payout/notional amounts of our purchased credit derivatives; and
- Fair values of our OTC derivative assets and derivative liabilities by tenor for each product type, including credit derivatives.

Response to the Commission's February 3, 2010 Letter

2. Regarding question 17 in the January 28, 2010 letter, you testified during the hearing that Goldman never anticipated receiving government help. Please define what you meant by "government help." Was the possibility of "government help" discussed with anyone? Would Goldman have been able to continue as a going concern without the government assistance it did receive? Were there any discussions about whether Goldman would have been able to continue as a going concern without government assistance or government help?

"Government help" would mean government assistance that directly affected Goldman Sachs' financial profile. We did not discuss the possibility of "government help"; and neither did we discuss whether we would be able to continue as a going concern without government assistance. In fact, three weeks before the TARP's Capital Purchase Program was announced, we raised \$5 billion of preferred equity from Berkshire Hathaway and \$5.75 billion in a common equity offering. As a result, we believe we were as well-capitalized as the strongest financial institutions. In addition, we had steadily been increasing our Global Core Excess pool of liquidity for several years, and it represented approximately \$113 billion on average during the third quarter of 2008.