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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-K**  
**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

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For the fiscal year ended November 28, 2008

Commission File Number: 001-14965

**The Goldman Sachs Group, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**13-4019460**  
(I.R.S. Employer  
Identification No.)

**85 Broad Street**  
**New York, N.Y.**  
(Address of principal executive offices)

**10004**  
(Zip Code)

**(212) 902-1000**  
(Registrant's telephone number, including area code)

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

<u>Title of each class:</u>	<u>Name of each exchange on which registered:</u>
Common stock, par value \$.01 per share, and attached Shareholder Protection Rights	New York Stock Exchange
Depository Shares, Each Representing 1/1,000th Interest in a Share of Floating Rate Non-Cumulative Preferred Stock, Series A	New York Stock Exchange
Depository Shares, Each Representing 1/1,000th Interest in a Share of 6.20% Non-Cumulative Preferred Stock, Series B	New York Stock Exchange
Depository Shares, Each Representing 1/1,000th Interest in a Share of Floating Rate Non-Cumulative Preferred Stock, Series C	New York Stock Exchange
Depository Shares, Each Representing 1/1,000th Interest in a Share of Floating Rate Non-Cumulative Preferred Stock, Series D	New York Stock Exchange
5.793% Fixed-to-Floating Rate Normal Automatic Preferred Enhanced Capital Securities of Goldman Sachs Capital II (and Registrant's guarantee with respect thereto)	New York Stock Exchange
Floating Rate Normal Automatic Preferred Enhanced Capital Securities of Goldman Sachs Capital III (and Registrant's guarantee with respect thereto)	New York Stock Exchange
Medium-Term Notes, Series B, Index-Linked Notes due February 2013; Index-Linked Notes due April 2013; Index-Linked Notes due May 2013; Index-Linked Notes due 2010; and Index-Linked Notes due 2011	NYSE Alternext US
Medium-Term Notes, Series B, 7.35% Notes due 2009; 7.80% Notes due 2010; and Floating Rate Notes due 2011	New York Stock Exchange
Medium-Term Notes, Series A, Index-Linked Notes due 2037 of GS Finance Corp. (and Registrant's guarantee with respect thereto)	NYSE Arca
Medium-Term Notes, Series B, Index-Linked Notes due 2037	NYSE Arca

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

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.  
Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Annual Report on Form 10-K or any amendment to the Annual Report on Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer (Do not check if a smaller reporting company) ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of May 30, 2008, the aggregate market value of the common stock of the registrant held by non-affiliates of the registrant was approximately \$68.2 billion.

As of January 16, 2009, there were 461,784,433 shares of the registrant's common stock outstanding.

**Documents incorporated by reference:** Portions of The Goldman Sachs Group, Inc.'s Proxy Statement for its 2009 Annual Meeting of Shareholders to be held on May 8, 2009 are incorporated by reference in the Annual Report on Form 10-K in response to Part III, Items 10, 11, 12, 13 and 14.

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**THE GOLDMAN SACHS GROUP, INC.**

**ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED NOVEMBER 28, 2008**

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## PART I

### Item 1. Business

#### Introduction

Goldman Sachs is a bank holding company and a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals. Goldman Sachs is the successor to a commercial paper business founded in 1869 by Marcus Goldman. On May 7, 1999, we converted from a partnership to a corporation and completed an initial public offering of our common stock. On September 21, 2008, The Goldman Sachs Group, Inc. (Group Inc.) became a bank holding company regulated by the Board of Governors of the Federal Reserve System (Federal Reserve Board) under the U.S. Bank Holding Company Act of 1956 (BHC Act). Our depository institution subsidiary, Goldman Sachs Bank USA (GS Bank USA), became a New York State-chartered bank on November 28, 2008.

Our activities are divided into three segments: (i) Investment Banking, (ii) Trading and Principal Investments and (iii) Asset Management and Securities Services.

All references to 2008, 2007 and 2006 refer to our fiscal years ended, or the dates, as the context requires, November 28, 2008, November 30, 2007 and November 24, 2006, respectively. When we use the terms “Goldman Sachs,” “the firm,” “we,” “us” and “our,” we mean The Goldman Sachs Group, Inc., a Delaware corporation, and its consolidated subsidiaries. References herein to our Annual Report on Form 10-K are to our Annual Report on Form 10-K for the fiscal year ended November 28, 2008.

On December 15, 2008, our Board of Directors approved a change in our fiscal year-end from the last Friday of November to the last Friday of December. The change is effective for our 2009 fiscal year. Our 2009 fiscal year began December 27, 2008 and will end December 25, 2009, resulting in a one-month transition period that began November 29, 2008 and ended December 26, 2008. Information on this one-month transition period will be included in our Quarterly Report on Form 10-Q for the three months ended March 27, 2009.

Financial information concerning our business segments and geographic regions for each of 2008, 2007 and 2006 is set forth in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” the consolidated financial statements and the notes thereto, and the supplemental financial information, which are in Part II, Items 7, 7A and 8 of our Annual Report on Form 10-K.

Our internet address is [www.gs.com](http://www.gs.com) and the investor relations section of our web site is located at [www.gs.com/shareholders](http://www.gs.com/shareholders). We make available free of charge, on or through the investor relations section of our web site, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934 (Exchange Act), as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission. Also posted on our web site, and available in print upon request of any shareholder to our Investor Relations Department, are our certificate of incorporation and by-laws, charters for our Audit Committee, Compensation Committee, and Corporate Governance and Nominating Committee, our Policy Regarding Director Independence Determinations, our Policy on Reporting of Concerns Regarding Accounting and Other Matters, our Corporate Governance Guidelines and our Code of Business Conduct and Ethics governing our directors, officers and employees. Within the time period required by the SEC and the New York Stock Exchange, we will post on our web site any amendment to the Code of Business Conduct and Ethics and any waiver applicable to any executive officer, director or senior financial officer (as defined in the Code). In addition, our web site includes information concerning purchases and sales of our equity securities by our executive officers and directors, as well as disclosure relating to certain non-GAAP financial measures (as defined in the SEC’s Regulation G) that we may make public orally, telephonically, by webcast, by broadcast or by similar means from time to time.

Our Investor Relations Department can be contacted at The Goldman Sachs Group, Inc., 85 Broad Street, 17th Floor, New York, New York 10004, Attn: Investor Relations, telephone: 212-902-0300, e-mail: [gs-investor-relations@gs.com](mailto:gs-investor-relations@gs.com).



### **Cautionary Statement Pursuant to the U.S. Private Securities Litigation Reform Act of 1995**

We have included or incorporated by reference in our Annual Report on Form 10-K, and from time to time our management may make, statements that may constitute “forward-looking statements” within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts but instead represent only our beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These statements include statements other than historical information or statements of current condition and may relate to our future plans and objectives and results, among other things, and may also include our belief regarding the effect of various legal proceedings, as set forth under “Legal Proceedings” in Part I, Item 3 of our Annual Report on Form 10-K, as well as statements about the objectives and effectiveness of our risk management and liquidity policies, statements about trends in or growth opportunities for our businesses, statements about our future status, activities or reporting under U.S. banking regulation, and statements about our investment banking transaction backlog, in Part II, Item 7 of our Annual Report on Form 10-K. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause our actual results and financial condition to differ from those indicated in the forward-looking statements include, among others, those discussed below and under “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K.

In the case of statements about our investment banking transaction backlog, such statements are subject to the risk that the terms of these transactions may be modified or that they may not be completed at all; therefore, the net revenues, if any, that we actually earn from these transactions may differ, possibly materially, from those currently expected. Important factors that could result in a modification of the terms of a transaction or a transaction not being completed include, in the case of underwriting transactions, a decline or continued weakness in general economic conditions, outbreak of hostilities, volatility in the securities markets generally or an adverse development with respect to the issuer of the securities and, in the case of financial advisory transactions, a decline in the securities markets, an inability to obtain adequate financing, an adverse development with respect to a party to the transaction or a failure to obtain a required regulatory approval. For a discussion of other important factors that could adversely affect our investment banking transactions, see “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K.



**Segment Operating Results**  
(in millions)

		Year Ended November		
		2008	2007	2006
<b>Investment Banking</b>	Net revenues	\$ 5,185	\$ 7,555	\$ 5,629
	Operating expenses	<u>3,143</u>	<u>4,985</u>	<u>4,062</u>
	Pre-tax earnings	<u>\$ 2,042</u>	<u>\$ 2,570</u>	<u>\$ 1,567</u>
<b>Trading and Principal Investments</b>	Net revenues	\$ 9,063	\$31,226	\$25,562
	Operating expenses	<u>11,808</u>	<u>17,998</u>	<u>14,962</u>
	Pre-tax earnings/(loss)	<u>\$ (2,745)</u>	<u>\$13,228</u>	<u>\$10,600</u>
<b>Asset Management and Securities Services</b>	Net revenues	\$ 7,974	\$ 7,206	\$ 6,474
	Operating expenses	<u>4,939</u>	<u>5,363</u>	<u>4,036</u>
	Pre-tax earnings	<u>\$ 3,035</u>	<u>\$ 1,843</u>	<u>\$ 2,438</u>
<b>Total</b>	Net revenues	\$22,222	\$45,987	\$37,665
	Operating expenses (1)	<u>19,886</u>	<u>28,383</u>	<u>23,105</u>
	Pre-tax earnings	<u>\$ 2,336</u>	<u>\$17,604</u>	<u>\$14,560</u>

(1) Operating expenses include net provisions for a number of litigation and regulatory proceedings of \$(4) million, \$37 million and \$45 million for the years ended November 2008, November 2007 and November 2006, respectively, that have not been allocated to our segments.

## **Where We Conduct Business**

As of November 28, 2008, we operated offices in over 30 countries and 43% of our 30,067 employees were based outside the Americas (which includes the countries in North and South America). In 2008, we derived 30% of our net revenues outside of the Americas. See geographic information in Note 18 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K.

Our clients are located worldwide, and we are an active participant in financial markets around the world. We have developed and continue to build strong investment banking relationships in new and developing markets. We also continue to expand our presence throughout these markets to invest strategically when opportunities arise and to work more closely with our private wealth and asset management clients in these regions. Our global reach is illustrated by the following:

- we are a member of and an active participant in most of the world's major stock, options and futures exchanges and marketplaces;
- we are a primary dealer in many of the largest government bond markets around the world;
- we have interbank dealer status in currency markets around the world;
- we are a member of or have relationships with major commodities exchanges worldwide; and
- we have commercial banking or deposit-taking institutions organized or operating in the United States, the United Kingdom, Ireland, Brazil, Switzerland, Germany, France, Russia and South Korea.

Our businesses are supported by our Global Investment Research division, which, as of November 2008, provided research coverage of over 3,250 companies worldwide and over 45 national economies, and maintained a presence in locations around the world.

We continue to expand our geographic reach. For example, in recent years we have opened offices in Mumbai, Moscow, Sao Paulo, Dubai, Qatar, Riyadh and Tel Aviv, become licensed as a broker-dealer in Russia, India and China, opened banks in Brazil, Ireland and Russia and entered into the asset management business in South Korea and India.

## Business Segments

The primary products and activities of our business segments are set forth in the following chart:

Business Segment/ <i>Component</i>	Primary Products and Activities
<b>Investment Banking:</b> <i>Financial Advisory</i>  <i>Underwriting</i>	<ul style="list-style-type: none"> <li>• Mergers and acquisitions advisory services</li> <li>• Financial restructuring advisory services</li> <li>• Equity and debt underwriting</li> </ul>
<b>Trading and Principal Investments:</b> <i>Fixed Income, Currency and Commodities</i>          <i>Equities</i>          <i>Principal Investments</i>	<ul style="list-style-type: none"> <li>• Commodities and commodity derivatives, including power generation and related activities</li> <li>• Credit products, including trading and investing in credit derivatives, investment-grade corporate securities, high-yield securities, bank and secured loans, municipal securities, emerging market and distressed debt, public and private equity securities and real estate</li> <li>• Currencies and currency derivatives</li> <li>• Interest rate products, including interest rate derivatives, global government securities and money market instruments, including matched book positions</li> <li>• Mortgage-related securities and loan products and other asset-backed instruments</li> <li>• Equity securities and derivatives</li> <li>• Securities, futures and options clearing services</li> <li>• Market-making and specialist activities in equity securities and options</li> <li>• Insurance activities</li> <li>• Principal investments in connection with merchant banking activities</li> <li>• Investment in the ordinary shares of Industrial and Commercial Bank of China Limited</li> </ul>
<b>Asset Management and Securities Services:</b> <i>Asset Management</i>          <i>Securities Services</i>	<ul style="list-style-type: none"> <li>• Investment advisory services, financial planning and investment products (primarily through separately managed accounts and commingled vehicles) across all major asset classes, including money markets, fixed income, equities and alternative investments (including hedge funds, private equity, real estate, currencies, commodities and asset allocation strategies), for institutional and individual investors (including high-net-worth clients, as well as retail clients through third-party channels)</li> <li>• Management of merchant banking funds</li> <li>• Prime brokerage</li> <li>• Financing services</li> <li>• Securities lending</li> </ul>



## **Investment Banking**

Investment Banking represented 23% of 2008 net revenues. We provide a broad range of investment banking services to a diverse group of corporations, financial institutions, investment funds, governments and individuals and seek to develop and maintain long-term relationships with these clients as their lead investment bank.

Our current structure, which is organized by regional, industry and product groups, seeks to combine client-focused investment bankers with execution and industry expertise. We continually assess and adapt our organization to meet the demands of our clients in each geographic region. Through our commitment to teamwork, we believe that we provide services in an integrated fashion for the benefit of our clients.

Our goal is to make available to our clients the entire resources of the firm in a seamless fashion, with investment banking serving as “front of the house.” To accomplish this objective, we focus on coordination among our equity and debt underwriting activities and our corporate risk and liability management activities. This coordination is intended to assist our investment banking clients in managing their asset and liability exposures and their capital.

Our Investment Banking segment is divided into two components: Financial Advisory and Underwriting.

### ***Financial Advisory***

Financial Advisory includes advisory assignments with respect to mergers and acquisitions, divestitures, corporate defense activities, restructurings and spin-offs. Our mergers and acquisitions capabilities are evidenced by our significant share of assignments in large, complex transactions for which we provide multiple services, including “one-stop” acquisition financing and cross-border structuring expertise, as well as services in other areas of the firm, such as interest rate and currency hedging. In particular, a significant number of the loan commitments and bank and bridge loan facilities that we enter into arise in connection with our advisory assignments.

### ***Underwriting***

Underwriting includes public offerings and private placements of a wide range of securities and other financial instruments, including common and preferred stock, convertible and exchangeable securities, investment-grade debt, high-yield debt, sovereign and emerging market debt, municipal debt, bank loans, asset-backed securities and real estate-related securities, such as mortgage-related securities and the securities of real estate investment trusts.

**Equity Underwriting.** Equity underwriting has been a long-term core strength of Goldman Sachs. As with mergers and acquisitions, we have been particularly successful in winning mandates for large, complex transactions. We believe our leadership in worldwide initial public offerings and worldwide public common stock offerings reflects our expertise in complex transactions, prior experience and distribution capabilities.

**Debt Underwriting.** We engage in the underwriting and origination of various types of debt instruments, including investment-grade debt securities, high-yield debt securities, bank and bridge loans and emerging market debt securities, which may be issued by, among others, corporate, sovereign and agency issuers. In addition, we underwrite and originate structured securities, which include mortgage-related securities and other asset-backed securities and collateralized debt obligations.

## **Trading and Principal Investments**

Trading and Principal Investments represented 41% of 2008 net revenues. Trading and Principal Investments facilitates client transactions with a diverse group of corporations, financial institutions, investment funds, governments and individuals and takes proprietary positions through market making in, trading of and investing in fixed income and equity products, currencies, commodities and derivatives on these products. In addition, we engage in market-making and specialist activities on equities and options exchanges, and we clear client transactions on major stock, options and futures exchanges worldwide. In connection with our merchant banking and other investing activities, we make principal investments directly and through funds that we raise and manage.

To meet the needs of our clients, Trading and Principal Investments is diversified across a wide range of products. We believe our willingness and ability to take risk to facilitate client transactions distinguishes us from many of our competitors and substantially enhances our client relationships.

Our Trading and Principal Investments segment is divided into three components: Fixed Income, Currency and Commodities; Equities; and Principal Investments.

### ***Fixed Income, Currency and Commodities and Equities***

Fixed Income, Currency and Commodities (FICC) and Equities are large and diversified operations through which we engage in a variety of client-driven and proprietary trading and investing activities.

In our client-driven businesses, FICC and Equities strive to deliver high-quality service by offering broad market-making and market knowledge to our clients on a global basis. In addition, we use our expertise to take positions in markets, by committing capital and taking risk, to facilitate client transactions and to provide liquidity. Our willingness to make markets, commit capital and take risk in a broad range of fixed income, currency, commodity and equity products and their derivatives is crucial to our client relationships and to support our underwriting business by providing secondary market liquidity.

We generate trading net revenues from our client-driven businesses in three ways:

- First, in large, highly liquid markets, we undertake a high volume of transactions for modest spreads and fees.
- Second, by capitalizing on our strong relationships and capital position, we undertake transactions in less liquid markets where spreads and fees are generally larger.
- Finally, we structure and execute transactions that address complex client needs.

Our FICC and Equities businesses operate in close coordination to provide clients with services and cross-market knowledge and expertise.

In our proprietary activities in both FICC and Equities, we assume a variety of risks and devote resources to identify, analyze and benefit from these exposures. We capitalize on our analytical models to analyze information and make informed trading judgments, and we seek to benefit from perceived disparities in the value of assets in the trading markets and from macroeconomic and issuer-specific trends.

## **FICC**

We make markets in and trade interest rate and credit products, mortgage-related securities and loan products and other asset-backed instruments, currencies and commodities, structure and enter into a wide variety of derivative transactions, and engage in proprietary trading and investing. FICC has five principal businesses: commodities; credit products; currencies; interest rate products, including money market instruments; and mortgage-related securities and loan products and other asset-backed instruments.

**Commodities.** We enter into trades with our clients in, make markets in, and trade for our own account a wide variety of commodities, commodity derivatives and interests in commodity-related assets, including oil and oil products, metals, natural gas and electricity, and forest products. As part of our commodities business, we acquire and dispose of interests in, and engage in the development and operation of, electric power generation facilities and related activities.

**Credit Products.** We offer to and trade for our clients a broad array of credit and credit-linked products all over the world, including credit derivatives, investment-grade corporate securities, high-yield securities, bank and secured loans (origination and trading), municipal securities, and emerging market and distressed debt. For example, we enter, as principal, into complex structured transactions designed to meet client needs.

In addition, we provide credit through bridge and other loan facilities to a broad range of clients. Commitments that are extended for contingent acquisition financing are often intended to be short-term in nature, as borrowers often seek to replace them with other funding sources. As part of our ongoing credit origination activities, we may seek to reduce our credit risk on commitments by syndicating all or substantial portions of commitments to other investors or, upon funding, by securitizing the positions through investment vehicles sold to other investors. Underwriting fees from syndications of these commitments are recorded in debt underwriting in our Investment Banking segment. However, to the extent that we recognize losses on these commitments, such losses are recorded within our Trading and Principal Investments segment, net of any related underwriting fees. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Contractual Obligations and Commitments” in Part II, Item 7 of our Annual Report on Form 10-K for additional information on our commitments.

Our credit products business includes making significant long-term and short-term investments for our own account (sometimes investing together with our merchant banking funds) in a broad array of asset classes (including distressed debt) globally. We opportunistically invest in debt and equity securities and secured loans, and in private equity, real estate and other assets.

**Currencies.** We act as a dealer in foreign exchange and trade for our clients and ourselves in most currencies on exchanges and in cash and derivative markets globally.

**Interest Rate Products.** We trade and make markets in a variety of interest rate products, including interest rate swaps, options and other derivatives, and government bonds, as well as money market instruments, such as commercial paper, treasury bills, repurchase agreements and other highly liquid securities and instruments. This business includes our matched book, which consists of short-term collateralized financing transactions.

**Mortgage Business.** We make markets in and trade for our clients and ourselves commercial and residential mortgage-related securities and loan products (including agency prime and non-agency prime, Alt-A and subprime mortgages) and other asset-backed and derivative instruments. We acquire positions in these products for proprietary trading purposes as well as for securitization or syndication. We also originate and service commercial and residential mortgages.

## **Equities**

We make markets in and trade equities and equity-related products, structure and enter into equity derivative transactions, and engage in proprietary trading. We generate commissions from executing and clearing client transactions on major stock, options and futures exchanges worldwide through our Equities client franchise and clearing activities.

Equities includes two principal businesses: our client franchise business and principal strategies. We also engage in specialist and insurance activities.

**Client Franchise Business.** Our client franchise business includes primarily client-driven activities in the shares, equity derivatives and convertible securities markets. These activities also include clearing client transactions on major stock, options and futures exchanges worldwide, as well as our options specialist and market-making businesses. Our client franchise business increasingly involves providing our clients with access to electronic “low-touch” equity trading platforms, and electronic trades account for the majority of our client trading activity in this business. However, a majority of our net revenues in this business continues to be derived from our traditional “high-touch” handling of more complex trades. We expect both types of trading activities to remain important components of our client franchise business.

We trade equity securities and equity-related products, including convertible securities, options, futures and over-the-counter (OTC) derivative instruments, on a global basis as an agent, as a market maker or otherwise as a principal. As a principal, we facilitate client transactions, often by committing capital and taking risk, to provide liquidity to clients with large blocks of stocks or options. For example, we are active in the execution of large block trades. We also execute transactions as agent and offer clients direct electronic access to trading markets.

In the options and futures markets, we structure, distribute and execute derivatives on market indices, industry groups, financial measures and individual company stocks to facilitate client transactions and our proprietary activities. We develop strategies and render advice with respect to portfolio hedging and restructuring and asset allocation transactions. We also create specially tailored instruments to enable sophisticated investors to undertake hedging strategies and to establish or liquidate investment positions. We are one of the leading participants in the trading and development of equity derivative instruments. In options, we are a specialist and/or market maker on the International Securities Exchange, the Chicago Board Options Exchange, NYSE Arca, the Boston Options Exchange, the Philadelphia Stock Exchange, NYSE Alternext US and the Chicago Mercantile Exchange.

**Principal Strategies.** Our principal strategies business is a multi-strategy investment business that invests and trades our capital across global markets. Investment strategies include fundamental equities and relative value trading (which involves trading strategies designed to take advantage of perceived discrepancies in the relative value of financial instruments, including equity, equity-related and debt instruments), event-driven investments (which focus on event-oriented special situations such as corporate restructurings, bankruptcies, recapitalizations, mergers and acquisitions, and legal and regulatory events), convertible bond trading, various types of volatility trading and principal finance.

At the start of our first fiscal quarter of 2008, we reassigned approximately one-half of the traders and other personnel and transferred approximately one-half of the firm’s assets comprising our principal strategies business to our asset management business in an effort to strengthen and diversify our asset management offerings. These assets are invested in an alternative investment fund managed by our asset management business.



**Specialist Activities.** Our specialist activities business consists of our stock and exchange-traded funds (ETF) specialist and market-making businesses. We engage in specialist and market-making activities on equities exchanges. In the United States, we are one of the leading designated market makers for stocks traded on the NYSE. For ETFs, we are registered market makers on NYSE Arca.

**Insurance Activities.** Through our insurance subsidiaries, we engage in a range of insurance and reinsurance businesses, including buying, originating and/or reinsuring variable annuity and life insurance contracts, reinsuring property catastrophe and residential homeowner risks and providing power interruption coverage to power generating facilities.

### ***Principal Investments***

Principal Investments primarily represents net revenues from three primary sources: returns on corporate and real estate investments; overrides on corporate and real estate investments made by merchant banking funds that we manage; and our investment in the ordinary shares of Industrial and Commercial Bank of China Limited (ICBC).

**Returns on Corporate and Real Estate Investments.** As of November 2008, the aggregate carrying value of our principal investments held directly or through our merchant banking funds, excluding our investment in the ordinary shares of ICBC, was \$15.13 billion, comprised of corporate principal investments with an aggregate carrying value of \$12.16 billion and real estate investments with an aggregate carrying value of \$2.97 billion. In addition, as of November 2008, we had outstanding unfunded equity capital commitments of up to \$13.47 billion, comprised of corporate principal investment commitments of \$10.39 billion and real estate investment commitments of \$3.08 billion.

**Overrides.** Consists of the increased share of the income and gains derived from our merchant banking funds when the return on a fund's investments over the life of the fund exceeds certain threshold returns (typically referred to as an override). Overrides are recognized in net revenues when all material contingencies have been resolved.

**ICBC.** Our investment in the ordinary shares of ICBC was acquired on April 28, 2006. The ordinary shares acquired from ICBC are subject to transfer restrictions that, among other things, prohibit any sale, disposition or other transfer until April 28, 2009. From April 28, 2009 to October 20, 2009, we may transfer up to 50% of the aggregate ordinary shares of ICBC that we owned as of October 20, 2006. We may transfer the remaining shares after October 20, 2009. As of November 2008, the fair value of our investment in the ordinary shares of ICBC was \$5.50 billion. A portion of our interest is held by investment funds managed by Goldman Sachs. For further information regarding our investment in the ordinary shares of ICBC, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies — Fair Value — Cash Instruments" in Part II, Item 7 of our Annual Report on Form 10-K.

## **Asset Management and Securities Services**

Asset Management and Securities Services represented 36% of 2008 net revenues. Our asset management business provides investment advisory and financial planning services and offers investment products (primarily through separately managed accounts and commingled vehicles) across all major asset classes to a diverse group of institutions and individuals worldwide and primarily generates revenues in the form of management and incentive fees. Securities Services provides prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide, and generates revenues primarily in the form of interest rate spreads or fees.

Our Asset Management and Securities Services segment is divided into two components: Asset Management and Securities Services.

### ***Asset Management***

We offer a broad array of investment strategies, advice and planning. We provide asset management services and offer investment products (primarily through separately managed accounts and commingled vehicles, such as mutual funds and private investment funds) across all major asset classes: money markets, fixed income, equities and alternative investments (including hedge funds, private equity, real estate, currencies, commodities and asset allocation strategies). Through our subsidiary, The Ayco Company, L.P., we also provide fee-based financial counseling and financial education in the United States.

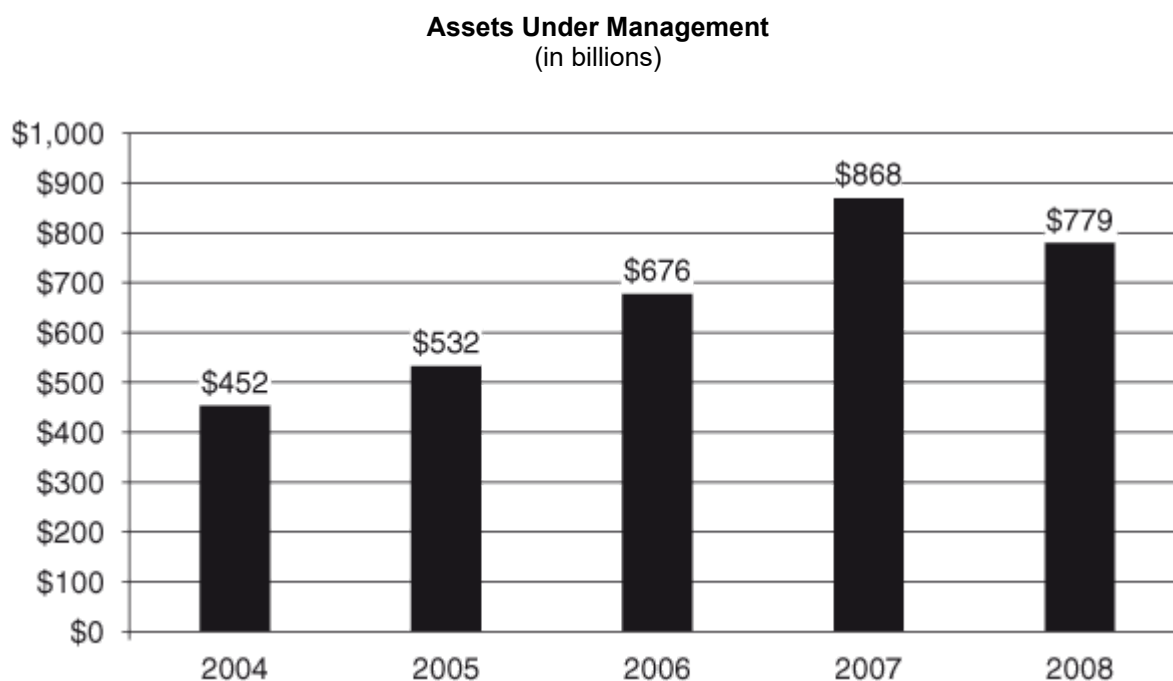
Assets under management (AUM) typically generate fees as a percentage of asset value, which is affected by investment performance and by inflows and redemptions. The fees that we charge vary by asset class, as do our related expenses. In certain circumstances, we are also entitled to receive incentive fees based on a percentage of a fund's return or when the return on assets under management exceeds specified benchmark returns or other performance targets. Incentive fees are recognized when the performance period ends and they are no longer subject to adjustment. We have numerous incentive fee arrangements, many of which have annual performance periods that end on December 31. For that reason, incentive fees have been seasonally weighted to our first quarter.

AUM includes our mutual funds, alternative investment funds and separately managed accounts for institutional and individual investors. Alternative investments include our merchant banking funds, which generate revenues as described below under “— Management of Merchant Banking Funds.” AUM includes assets in clients' brokerage accounts to the extent that they generate fees based on the assets in the accounts rather than commissions on transactional activity in the accounts.

AUM does not include assets in brokerage accounts that generate commissions, mark-ups and spreads based on transactional activity, or our own investments in funds that we manage. Net revenues from these assets are included in our Trading and Principal Investments segment. AUM also does not include non-fee-paying assets, including interest-bearing deposits held through our bank depository institution subsidiaries.

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The amount of AUM is set forth in the graph below. In the following graph, as well as in the following tables, substantially all assets under management are valued as of November 30:



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The following table sets forth AUM by asset class:

**Assets Under Management by Asset Class**  
(in billions)

	As of November 30		
	2008	2007	2006
Alternative investments (1)	\$146	\$151	\$145
Equity	112	255	215
Fixed income	248	256	198
Total non-money market assets	506	662	558
Money markets	273	206	118
Total assets under management	<u>\$779</u>	<u>\$868</u>	<u>\$676</u>

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(1) Primarily includes hedge funds, private equity, real estate, currencies, commodities and asset allocation strategies.

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**Clients.** Our clients are institutions and individuals, including both high-net-worth and retail investors. We access institutional and high-net-worth clients through both direct and third-party channels and retail clients primarily through third-party channels. Our institutional clients include pension funds, governmental organizations, corporations, insurance companies, banks, foundations and endowments. In third-party distribution channels, we distribute our mutual funds, alternative investment funds and separately managed accounts through brokerage firms, banks, insurance companies and other financial intermediaries. Our clients are located worldwide.

The table below sets forth the amount of AUM by distribution channel and client category:

### **Assets Under Management by Distribution Channel** (in billions)

	<b>As of November 30</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
• Directly Distributed			
— Institutional	\$273	\$354	\$296
— High-net-worth individuals	215	219	177
• Third-Party Distributed			
— Institutional, high-net-worth individuals and retail	<u>291</u>	<u>295</u>	<u>203</u>
Total	<u>\$779</u>	<u>\$868</u>	<u>\$676</u>

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**Management of Merchant Banking Funds.** Goldman Sachs sponsors numerous corporate and real estate private investment funds. As of November 2008, the amount of AUM in these funds (including both funded amounts and unfunded commitments on which we earn fees) was \$93 billion.

Our strategy with respect to these funds generally is to invest opportunistically to build a portfolio of investments that is diversified by industry, product type, geographic region, and transaction structure and type. Our corporate investment funds pursue, on a global basis, long-term investments in equity and debt securities in privately negotiated transactions, leveraged buyouts, acquisitions and investments in funds managed by external parties. Our real estate investment funds invest in real estate operating companies, debt and equity interests in real estate assets, and other real estate-related investments. In addition, our merchant banking funds include funds that invest in infrastructure and infrastructure-related assets and companies on a global basis.

Merchant banking activities generate three primary revenue streams. First, we receive a management fee that is generally a percentage of a fund's committed capital, invested capital, total gross acquisition cost or asset value. These annual management fees are included in our Asset Management net revenues. Second, Goldman Sachs, as a substantial investor in some of these funds, is allocated its proportionate share of the funds' unrealized appreciation or depreciation arising from changes in fair value as well as gains and losses upon realization. Third, after a fund has achieved a minimum return for fund investors, we receive an increased share of the fund's income and gains that is a percentage of the income and gains from the fund's investments. The second and third of these revenue streams are included in Principal Investments within our Trading and Principal Investments segment.

## **Securities Services**

Securities Services provides prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide.

**Prime brokerage services.** We offer prime brokerage services to our clients, allowing them the flexibility to trade with most brokers while maintaining a single source for financing and consolidated portfolio reports. Our prime brokerage business provides clearing and custody in 53 markets globally and provides consolidated multi-currency accounting and reporting, fund administration and other ancillary services.

**Financing services.** A central element of our prime brokerage business involves providing financing to our clients for their securities trading activities through margin and securities loans that are collateralized by securities, cash or other acceptable collateral.

**Securities lending services.** Securities lending services principally involve the borrowing and lending of securities to cover clients' and Goldman Sachs' short sales and otherwise to make deliveries into the market. In addition, we are an active participant in the broker-to-broker securities lending business and the third-party agency lending business. Net revenues in securities lending services are, as a general matter, weighted toward our second and third quarters each year due to seasonally higher activity levels in Europe.

## **Global Investment Research**

Global Investment Research provides fundamental research on companies, industries, economies, currencies and commodities and macro strategy research on a worldwide basis.

Global Investment Research employs a team approach that as of November 2008 provided research coverage of over 3,250 companies worldwide and over 45 national economies. This is accomplished by the following departments:

- The Equity Research Departments provide fundamental analysis, earnings forecasts and investment opinions for equity securities;
- The Credit Research Department provides fundamental analysis, forecasts and investment opinions as to investment-grade and high-yield corporate bonds and credit derivatives; and
- The Global ECS Department (formed in December 2008 through a consolidation of the Economic, Commodities and Strategy Research Departments) formulates macroeconomic forecasts for economic activity, foreign exchange and interest rates, provides research on the commodity markets, and provides equity market forecasts, opinions on both asset and industry sector allocation, equity trading strategies, credit trading strategies and options research.

Further information regarding research at Goldman Sachs is provided below under “— Regulation — Regulations Applicable in and Outside the United States” and “Legal Proceedings — Research Independence Matters” in Part I, Item 3 of our Annual Report on Form 10-K.

## **Business Continuity and Information Security**

Business continuity and information security are high priorities for Goldman Sachs. Our Business Continuity Program has been developed to provide reasonable assurance of business continuity in the event of disruptions at the firm's critical facilities and to comply with the regulatory requirements of the Financial Industry Regulatory Authority (FINRA). Because we are a bank holding company, our Business Continuity Program will be subject to review by the Federal Reserve Board. The key elements of the program are crisis management, people recovery facilities, business recovery, systems and data recovery, and process improvement. In the area of information security, we have developed and implemented a framework of principles, policies and technology to protect the information assets of the firm and our clients. Safeguards are applied to maintain the confidentiality, integrity and availability of information resources.

## **Employees**

Management believes that a major strength and principal reason for the success of Goldman Sachs is the quality and dedication of our people and the shared sense of being part of a team. We strive to maintain a work environment that fosters professionalism, excellence, diversity, cooperation among our employees worldwide and high standards of business ethics.

Instilling the Goldman Sachs culture in all employees is a continuous process, in which training plays an important part. All employees are offered the opportunity to participate in education and periodic seminars that we sponsor at various locations throughout the world. Another important part of instilling the Goldman Sachs culture is our employee review process. Employees are reviewed by supervisors, co-workers and employees they supervise in a 360-degree review process that is integral to our team approach.

As of November 2008, we had 30,067 employees, excluding 4,671 employees of certain consolidated entities that are held for investment purposes only. Consolidated entities held for investment purposes are entities that are held strictly for capital appreciation, have a defined exit strategy and are engaged in activities that are not closely related to our principal businesses.

## **Competition**

The financial services industry — and all of our businesses — are intensely competitive, and we expect them to remain so. Our competitors are other entities that provide investment banking, securities and investment management services, as well as those entities that make investments in securities, commodities, derivatives, real estate, loans and other financial assets. These entities include brokers and dealers, investment banking firms, commercial banks, insurance companies, investment advisers, mutual funds, hedge funds, private equity funds and merchant banks. We compete with some of our competitors globally and with others on a regional, product or niche basis. Our competition is based on a number of factors, including transaction execution, our products and services, innovation, reputation and price.

We also face intense competition in attracting and retaining qualified employees. Our ability to continue to compete effectively in our businesses will depend upon our ability to attract new employees and retain and motivate our existing employees.

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Over time, there has been substantial consolidation and convergence among companies in the financial services industry. This trend accelerated over the course of the past year as the credit crisis caused numerous mergers and asset acquisitions among industry participants. Many commercial banks and other broad-based financial services firms have had the ability for some time to offer a wide range of products, from loans, deposit-taking and insurance to brokerage, asset management and investment banking services, which may enhance their competitive position. They also have had the ability to support investment banking and securities products with commercial banking, insurance and other financial services revenues in an effort to gain market share, which has resulted in pricing pressure in our investment banking and trading businesses and could result in pricing pressure in other of our businesses.

Moreover, we have faced, and expect to continue to face, pressure to retain market share by committing capital to businesses or transactions on terms that offer returns that may not be commensurate with their risks. In particular, corporate clients seek such commitments (such as agreements to participate in their commercial paper backstop or other loan facilities) from financial services firms in connection with investment banking and other assignments.

We provide these commitments primarily through GS Bank USA and its subsidiaries, including our William Street entities and Goldman Sachs Credit Partners L.P. With respect to most of the William Street commitments, Sumitomo Mitsui Financial Group, Inc. (SMFG) provides us with credit loss protection that is generally limited to 95% of the first loss we realize on approved loan commitments, up to a maximum of \$1.00 billion. In addition, subject to the satisfaction of certain conditions, upon our request, SMFG will provide protection for 70% of additional losses on such commitments, up to a maximum of \$1.13 billion, of which \$375 million of protection has been provided as of November 2008. We also use other financial instruments to mitigate credit risks related to certain William Street commitments not covered by SMFG. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Contractual Obligations and Commitments” in Part II, Item 7 of our Annual Report on Form 10-K and Note 8 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for more information regarding the William Street entities and for a description of the credit loss protection provided by SMFG. An increasing number of our commitments in connection with investment banking and other assignments do not meet the criteria established for the William Street entities and do not benefit from the SMFG loss protection. These commitments are issued through GS Bank USA and its subsidiaries or our other subsidiaries.

The trend toward consolidation and convergence has significantly increased the capital base and geographic reach of some of our competitors. This trend has also hastened the globalization of the securities and other financial services markets. As a result, we have had to commit capital to support our international operations and to execute large global transactions. To take advantage of some of our most significant challenges and opportunities, we will have to compete successfully with financial institutions that are larger and better capitalized and that may have a stronger local presence and longer operating history outside the United States.

We have experienced intense price competition in some of our businesses in recent years. There has been considerable pressure in the pricing of block trades. Also, equity and debt underwriting discounts, as well as trading spreads, have been under pressure for a number of years and the ability to execute trades electronically, through the internet and through alternative trading systems, has increased the pressure on trading commissions. It appears that this trend toward electronic and other “low-touch,” low-commission trading will continue. We believe that we will continue to experience competitive pressures in these and other areas in the future as some of our competitors seek to obtain market share by reducing prices.



## **Regulation**

Goldman Sachs, as a participant in the banking, securities, commodity futures and options and insurance industries, is subject to extensive regulation in the United States and the other countries in which we operate. See “Risk Factors — Our businesses and those of our clients are subject to extensive and pervasive regulation around the world” in Part I, Item 1A of our Annual Report on Form 10-K for a further discussion of the effect that regulation may have on our businesses. As a matter of public policy, regulatory bodies around the world are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of clients participating in those markets, including depositors in U.S. depository institutions such as GS Bank USA. They are not, however, generally charged with protecting the interests of Goldman Sachs’ shareholders or creditors.

On September 21, 2008, Group Inc. became a bank holding company under the BHC Act. As of that date, the Federal Reserve Board became the primary U.S. regulator of Group Inc., as a consolidated entity. Prior to September 21, 2008, Group Inc. was subject to regulation by the SEC as a Consolidated Supervised Entity (CSE) and was subject to group-wide supervision and examination by the SEC and to minimum capital standards on a consolidated basis. On September 26, 2008, the SEC announced that it was ending the CSE program. Our principal U.S. broker-dealer, Goldman, Sachs & Co. (GS&Co.) remains subject to regulation by the SEC.

### **Banking Regulation**

#### ***Supervision and Regulation***

As a bank holding company under the BHC Act, Group Inc. is now subject to supervision and examination by the Federal Reserve Board. Under the system of “functional regulation” established under the BHC Act, the Federal Reserve Board supervises Group Inc., including all of its nonbank subsidiaries, as an “umbrella regulator” of the consolidated organization and generally defers to the primary U.S. regulators of Group Inc.’s U.S. depository institution subsidiary, as applicable, and to the other U.S. regulators of Group Inc.’s U.S. non-depository institution subsidiaries that regulate certain activities of those subsidiaries. Such “functionally regulated” non-depository institution subsidiaries include broker-dealers registered with the SEC, insurance companies regulated by state insurance authorities, investment advisors registered with the SEC with respect to their investment advisory activities and entities regulated by the U.S. Commodity Futures Trading Commission (CFTC) with respect to certain futures-related activities.

#### ***Activities***

The BHC Act generally restricts us from engaging in business activities other than the business of banking and certain closely related activities. However, the BHC Act also grants a new bank holding company, such as Group Inc., two years from the date the entity becomes a bank holding company to comply with the restrictions on its activities imposed by the BHC Act with respect to any activities that it was engaged in when it became a bank holding company. We expect that this “grandfather” right will allow us to continue to conduct our business substantially as we have in the past until at least September 22, 2010. In addition, under the BHC Act, we can apply to the Federal Reserve Board for up to three one-year extensions.

Under the U.S. Gramm-Leach-Bliley Act of 1999 (GLB Act), an eligible bank holding company may elect to become a “financial holding company.” Financial holding companies may engage in a broader range of financial and related activities than are permissible for bank holding companies as long as they continue to meet the eligibility requirements for financial holding companies. These activities include underwriting, dealing and making markets in securities, insurance underwriting and making merchant banking investments in nonfinancial companies. In addition, the GLB Act also allows a company that was not a bank holding company and becomes a financial holding company after November 12, 1999 to continue to engage in certain commodities activities that are otherwise



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impermissible for bank holding companies if the company was engaged in any of these activities in the United States as of September 30, 1997 and if the assets held pursuant to these activities do not equal 5% or more of the consolidated assets of the bank holding company.

We intend to apply to elect to become a financial holding company under the GLB Act as soon as practicable. Our ability to achieve and maintain financial holding company status is dependent on a number of factors, including our U.S. depository institution subsidiaries continuing to qualify as “well capitalized” as described under “— Prompt Corrective Action” below. We do not believe that any activities that are material to our current or currently proposed business would be impermissible activities for us as a financial holding company.

As a bank holding company, Group Inc. is required to obtain prior Federal Reserve Board approval before directly or indirectly acquiring more than 5% of any class of voting shares of any unaffiliated depository institution. In addition, as a bank holding company, we may generally engage in banking and other financial activities abroad, including investing in and owning non-U.S. banks, if those activities and investments do not exceed certain limits and, in some cases, if we have obtained the prior approval of the Federal Reserve Board.

### **Capital Requirements**

We are subject to regulatory capital requirements administered by the U.S. federal banking agencies. Our bank depository institution subsidiaries, including GS Bank USA, are subject to similar capital guidelines. Under the Federal Reserve Board’s capital adequacy guidelines and the regulatory framework for prompt corrective action (PCA) that is applicable to GS Bank USA, Goldman Sachs and its bank depository institution subsidiaries must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory reporting practices. Goldman Sachs and its bank depository institution subsidiaries’ capital amounts, as well as GS Bank USA’s PCA classification, are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. We anticipate reporting capital ratios as follows:

- Before we became a bank holding company, we were subject to capital guidelines by the SEC as a CSE that were generally consistent with those set out in the Revised Framework for the International Convergence of Capital Measurement and Capital Standards issued by the Basel Committee on Banking Supervision (Basel II). We currently compute and report our firmwide capital ratios in accordance with the Basel II requirements as applicable to us when we were regulated as a CSE for the purpose of assessing the adequacy of our capital. We expect to continue to report to investors for a period of time our Basel II capital ratios as applicable to us when we were regulated as a CSE.
- The regulatory capital guidelines currently applicable to bank holding companies are based on the Capital Accord of the Basel Committee on Banking Supervision (Basel I), with Basel II to be phased in over time. We are currently working with the Federal Reserve Board to put in place the appropriate reporting and compliance mechanisms and methodologies to allow reporting of the Basel I capital ratios as of the end of March 2009.
- In addition, we are currently working to implement the Basel II framework as applicable to us as a bank holding company (as opposed to as a CSE). U.S. banking regulators have incorporated the Basel II framework into the existing risk-based capital requirements by requiring that internationally active banking organizations, such as Group Inc., transition to Basel II over the next several years.

Under the Basel II framework as it applied to us when we were regulated as a CSE, we evaluate our Tier 1 Capital and Total Allowable Capital as a percentage of Risk-Weighted Assets (RWAs). RWAs are calculated based on the level of market risk, credit risk and operational risk associated with our business activities, using methodologies generally consistent with those set out in Basel II. Our

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Tier 1 Capital consists of common shareholders' equity, qualifying preferred stock (including the cumulative preferred stock issued by Group Inc. to the U.S. Department of the Treasury's (U.S. Treasury) TARP Capital Purchase Program and our junior subordinated debt issued to trusts, less deductions for goodwill, disallowed intangible assets and other items. Our Total Allowable Capital consists of our Tier 1 Capital and our qualifying subordinated debt, less certain deductions. Additional information on the calculation of our Tier 1 Capital, Total Allowable Capital and RWAs under the Basel II framework as it applied to us as a CSE is set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Equity Capital — Consolidated Capital Requirements," and in Note 17 to the consolidated financial statements, which are in Part II, Items 7 and 8 of our Annual Report on Form 10-K. As of November 2008, our Total Capital Ratio (Total Allowable Capital as a percentage of RWAs) was 18.9% and our Tier 1 Ratio (Tier 1 Capital as a percentage of RWAs) was 15.6%, in each case calculated under the Basel II framework as it applied to us when we were regulated as a CSE.

As noted above, we are currently working to implement the Basel II framework as applicable to us as a bank holding company (as opposed to as a CSE). During a parallel period, we anticipate that Group Inc.'s capital calculations computed under both the Basel I rules and the Basel II rules will be reported to the Federal Reserve Board for examination and compliance for at least four consecutive quarterly periods. Once the parallel period and subsequent three-year transition period are successfully completed, Group Inc. will utilize the Basel II framework as its means of capital adequacy assessment, measurement and reporting and will discontinue use of Basel I. Internationally, the Basel II framework was implemented in several countries during the second half of 2007 and in 2008, while others will begin implementation in 2009. The Basel II rules therefore also apply to certain of our operations in non-U.S. jurisdictions.

The Federal Reserve Board also has established minimum leverage ratio guidelines. We were not subject to these guidelines before becoming a bank holding company and, accordingly, we are currently working with the Federal Reserve Board to finalize our methodology for calculating this ratio. The Tier 1 leverage ratio is defined as Tier 1 capital (as applicable to us as a bank holding company) divided by adjusted average total assets (which includes adjustments for disallowed goodwill and certain intangible assets). The minimum Tier 1 leverage ratio is 3% for bank holding companies that have received the highest supervisory rating under Federal Reserve Board guidelines or that have implemented the Federal Reserve Board's risk-based capital measure for market risk. Other bank holding companies must have a minimum Tier 1 leverage ratio of 4%. Bank holding companies may be expected to maintain ratios well above the minimum levels, depending upon their particular condition, risk profile and growth plans. As of November 2008, our estimated Tier 1 leverage ratio was 6.1%. This ratio represents a preliminary estimate and may be revised in subsequent filings as we continue to work with the Federal Reserve Board to finalize the methodology for the calculation.

GS&Co. will continue to calculate its regulatory capital requirements in accordance with the market and credit risk standards of Appendix E of Rule 15c3-1 under the Exchange Act, which are consistent with Basel II.

### ***Payment of Dividends***

Federal and state law imposes limitations on the payment of dividends by our bank depository institution subsidiaries. The amount of dividends that may be paid by a state-chartered bank that is a member of the Federal Reserve System, such as GS Bank USA or our national bank trust company subsidiary, is limited to the lesser of the amounts calculated under a "recent earnings" test and an "undivided profits" test. Under the recent earnings test, a dividend may not be paid if the total of all dividends declared by a bank in any calendar year is in excess of the current year's net income combined with the retained net income of the two preceding years, unless the bank obtains the approval of its chartering authority. Under the undivided profits test, a dividend may not be paid in excess of a bank's "undivided profits." New York law imposes similar limitations on New York State-

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chartered banks. As a result of these restrictions, GS Bank USA was not able to declare dividends to Group Inc. without regulatory approval as of November 2008.

In addition to the dividend restrictions described above, the banking regulators have authority to prohibit or to limit the payment of dividends by the banking organizations they supervise if, in the banking regulator's opinion, payment of a dividend would constitute an unsafe or unsound practice in light of the financial condition of the banking organization.

It is also the policy of the Federal Reserve Board that a bank holding company generally only pay dividends on common stock out of net income available to common shareholders over the past year and only if the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality, and overall financial condition. In the current financial and economic environment, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy and has discouraged dividend pay-out ratios that are at the 100% level unless both asset quality and capital are very strong. A bank holding company also should not maintain a dividend level that places undue pressure on the capital of bank depository institution subsidiaries, or that may undermine the bank holding company's ability to serve as a source of strength for such bank depository institution subsidiaries. See "— U.S. Treasury's TARP Capital Purchase Program" below for a discussion of additional restrictions on Group Inc.'s ability to pay dividends. In addition, certain of Group Inc.'s nonbank subsidiaries are subject to separate regulatory limitations on dividends and distributions, including our broker-dealer and our insurance subsidiaries as described below.

### ***Source of Strength***

Under Federal Reserve Board policy, Group Inc. is expected to act as a source of strength to GS Bank USA and to commit capital and financial resources to support this subsidiary. The required support may be needed at times when, absent that Federal Reserve Board policy, we may not find ourselves able to provide it. Capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulator to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

However, because the BHC Act provides for functional regulation of bank holding company activities by various regulators, the BHC Act prohibits the Federal Reserve Board from requiring payment by a holding company or subsidiary to a depository institution if the functional regulator of the payor objects to such payment. In such a case, the Federal Reserve Board could instead require the divestiture of the depository institution and impose operating restrictions pending the divestiture.

### ***Cross-guarantee Provisions***

Each insured depository institution "controlled" (as defined in the BHC Act) by the same bank holding company can be held liable to the U.S. Federal Deposit Insurance Corporation (FDIC) for any loss incurred, or reasonably expected to be incurred, by the FDIC due to the default of any other insured depository institution controlled by that holding company and for any assistance provided by the FDIC to any of those banks that is in danger of default. Such a "cross-guarantee" claim against a depository institution is generally superior in right of payment to claims of the holding company and its affiliates against that depository institution. At this time, we control only one insured depository institution for this purpose, namely GS Bank USA. However, if, in the future, we were to control other insured depository institutions, such cross-guarantee would apply to all such insured depository institutions.

### ***U.S. Treasury's TARP Capital Purchase Program***

On October 28, 2008, Group Inc. issued preferred stock and a warrant to purchase its common stock to the U.S. Treasury as a participant in the TARP Capital Purchase Program. Prior to October 28, 2011, unless we have redeemed all of this preferred stock or the U.S. Treasury has transferred all of this preferred stock to a third party, the consent of the U.S. Treasury will be required for us to, among other things, increase our common stock dividend above the current quarterly cash dividend of \$0.35 per share or repurchase our common stock or outstanding preferred stock except in limited circumstances. In addition, until the U.S. Treasury ceases to own any Group Inc. securities sold under the TARP Capital Purchase Program, the compensation arrangements for our senior executive officers must comply in all respects with the U.S. Emergency Economic Stabilization Act of 2008 and the rules and regulations thereunder. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Equity Capital — Equity Capital Management" in Part II, Item 7 of our Annual Report on Form 10-K for a further discussion of our participation in the U.S. Treasury's TARP Capital Purchase Program.

### ***FDIC Temporary Liquidity Guarantee Program***

Group Inc. and GS Bank USA have chosen to participate in the FDIC's Temporary Liquidity Guarantee Program (TLGP), which applies to, among others, all U.S. depository institutions insured by the FDIC and all U.S. bank holding companies, unless they have opted out of the TLGP or the FDIC has terminated their participation. Under the TLGP, the FDIC guarantees certain senior unsecured debt of Group Inc. and GS Bank USA, as well as noninterest-bearing transaction account deposits at GS Bank USA, and in return for these guarantees the FDIC is paid a fee based on the amount of the deposit or the amount and maturity of the debt. Under the debt guarantee component of the TLGP, the FDIC will pay the unpaid principal and interest on an FDIC-guaranteed debt instrument upon the uncured failure of the participating entity to make a timely payment of principal or interest in accordance with the terms of the instrument. Under the transaction account guarantee component of the TLGP, all noninterest-bearing transaction accounts maintained at GS Bank USA are insured in full by the FDIC until December 31, 2009, regardless of the standard maximum deposit insurance amount. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Funding Risk — Conservative Liability Structure" in Part II, Item 7 of our Annual Report on Form 10-K for a further discussion of our participation in the TLGP.

### ***GS Bank USA***

Our U.S. depository institution subsidiary, GS Bank USA, a New York State-chartered bank and a member of the Federal Reserve System and the FDIC, is regulated by the Federal Reserve Board and the New York State Banking Department and is subject to minimum capital requirements that (subject to certain exceptions) are similar to those applicable to bank holding companies. GS Bank USA was formed in November 2008 through the merger of our existing Utah industrial bank (named GS Bank USA) into our New York limited purpose trust company, with the surviving company taking the name GS Bank USA. Concurrently with this merger, we contributed subsidiaries with an aggregate of \$117.16 billion of assets into GS Bank USA (which brought total assets in GS Bank USA to \$145.06 billion as of November 2008). As a result, a number of our businesses are now conducted partially or entirely through GS Bank USA, including: bank loan trading and origination; interest rate, credit, currency and other derivatives; leveraged finance; commercial and residential mortgage origination, trading and servicing; structured finance; and agency lending, custody and hedge fund administration services. The businesses conducted through GS Bank USA are now subject to regulation by the Federal Reserve Board, the New York State Banking Department and the FDIC.

### ***Deposit Insurance***

GS Bank USA accepts deposits, and those deposits have the benefit of FDIC insurance up to the applicable limits. The FDIC's Deposit Insurance Fund is funded by assessments on insured depository institutions, which depend on the risk category of an institution and the amount of insured deposits that it holds. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis. We are also participants in the TLGP as discussed above under "— FDIC Temporary Liquidity Guarantee Program."

### ***Prompt Corrective Action***

The U.S. Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), among other things, requires the federal banking agencies to take "prompt corrective action" in respect of depository institutions that do not meet specified capital requirements. FDICIA establishes five capital categories for FDIC-insured banks: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A depository institution is deemed to be "well capitalized," the highest category, if it has a total capital ratio of 10% or greater, a Tier 1 capital ratio of 6% or greater and a Tier 1 leverage ratio of 5% or greater and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure. In connection with the November 2008 asset transfer described below, GS Bank USA agreed with the Federal Reserve Board to minimum capital ratios in excess of these "well capitalized" levels. Accordingly, for a period of time, GS Bank USA is expected to maintain a Tier 1 capital ratio of at least 8%, a total capital ratio of at least 11% and a Tier 1 leverage ratio of at least 6%. We contributed subsidiaries with an aggregate of \$117.16 billion in assets into GS Bank USA in November 2008 (which brought total assets in GS Bank USA to \$145.06 billion as of November 2008). As a result, we are currently working with the Federal Reserve Board to finalize our methodology for the Basel I calculations. As of November 2008, under Basel I, GS Bank USA's estimated Tier 1 capital ratio was 8.9% and estimated total capital ratio was 11.6%. In addition, GS Bank USA's estimated Tier 1 leverage ratio was 9.1%. An institution may be downgraded to, or deemed to be in, a capital category that is lower than is indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters.

FDICIA imposes progressively more restrictive constraints on operations, management and capital distributions, as the capital category of an institution declines. Failure to meet the capital guidelines could also subject a depository institution to capital raising requirements. Ultimately, critically undercapitalized institutions are subject to the appointment of a receiver or conservator.

The prompt corrective action regulations apply only to depository institutions and not to bank holding companies such as Group Inc. However, the Federal Reserve Board is authorized to take appropriate action at the holding company level, based upon the undercapitalized status of the holding company's depository institution subsidiaries. In certain instances relating to an undercapitalized depository institution subsidiary, the bank holding company would be required to guarantee the performance of the undercapitalized subsidiary's capital restoration plan and might be liable for civil money damages for failure to fulfill its commitments on that guarantee. Furthermore, in the event of the bankruptcy of the parent holding company, the guarantee would take priority over the parent's general unsecured creditors.

### ***Insolvency of an Insured Depository Institution***

If the FDIC is appointed the conservator or receiver of an insured depository institution such as GS Bank USA, upon its insolvency or in certain other events, the FDIC has the power:

- to transfer any of the depository institution's assets and liabilities to a new obligor without the approval of the depository institution's creditors;



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- to enforce the terms of the depository institution's contracts pursuant to their terms; or
- to repudiate or disaffirm any contract or lease to which the depository institution is a party, the performance of which is determined by the FDIC to be burdensome and the disaffirmance or repudiation of which is determined by the FDIC to promote the orderly administration of the depository institution.

In addition, under federal law, the claims of holders of deposit liabilities and certain claims for administrative expenses against an insured depository institution would be afforded a priority over other general unsecured claims against such an institution, including claims of debt holders of the institution, in the "liquidation or other resolution" of such an institution by any receiver. As a result, whether or not the FDIC ever sought to repudiate any debt obligations of GS Bank USA, the debt holders would be treated differently from, and could receive, if anything, substantially less than, the depositors of the depository institution.

### ***Transactions with Affiliates***

Transactions between GS Bank USA and Group Inc. and its subsidiaries and affiliates are regulated by the Federal Reserve Board. These regulations limit the types and amounts of transactions (including loans to and credit extensions from GS Bank USA) that may take place and generally require those transactions to be on an arms-length basis. These regulations generally do not apply to transactions between GS Bank USA and its subsidiaries. In November 2008, Group Inc. transferred assets and operations to GS Bank USA as described above under "— GS Bank USA." In connection with this transfer, Group Inc. entered into a guarantee agreement with GS Bank USA whereby Group Inc. agreed to (i) purchase from GS Bank USA certain transferred assets (other than derivatives and mortgage servicing rights) or reimburse GS Bank USA for certain losses relating to those assets; (ii) reimburse GS Bank USA for credit-related losses from assets transferred to GS Bank USA; and (iii) protect GS Bank USA or reimburse it for certain losses arising from derivatives and mortgage servicing rights transferred to GS Bank USA. Group Inc. also agreed to pledge to GS Bank USA collateral with an aggregate value at any time not less than 5% of the face amount of committed but unfunded credit lines plus the original transfer value of the assets transferred to GS Bank USA, which amounted to a required collateral value of approximately \$7.1 billion as of November 2008.

### ***Trust Companies***

Group Inc.'s two limited purpose trust company subsidiaries operate under state or federal law. They are not permitted to and do not accept deposits (other than as incidental to their trust activities) or make loans and, as a result, are not insured by the FDIC. The Goldman Sachs Trust Company, N.A., a national banking association that is limited to fiduciary activities, is regulated by the Office of the Comptroller of the Currency and is a member bank of the Federal Reserve System. The Goldman Sachs Trust Company of Delaware, a Delaware limited purpose trust company, is regulated by the Office of the Delaware State Bank Commissioner.

### **U.S. Securities and Commodities Regulation**

Goldman Sachs' broker-dealer subsidiaries are subject to regulations that cover all aspects of the securities business, including sales methods, trade practices, use and safekeeping of clients' funds and securities, capital structure, recordkeeping, the financing of clients' purchases, and the conduct of directors, officers and employees.

In the United States, the SEC is the federal agency responsible for the administration of the federal securities laws. GS&Co. is registered as a broker-dealer and as an investment adviser with the SEC and as a broker-dealer in all 50 states and the District of Columbia. Self-regulatory organizations, such as FINRA and the NYSE, adopt rules that apply to, and examine, broker-dealers such as GS&Co. In addition, state securities and other regulators also have regulatory or oversight

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authority over GS&Co. Similarly, our businesses are also subject to regulation by various non-U.S. governmental and regulatory bodies and self-regulatory authorities in virtually all countries where we have offices. Goldman Sachs Execution & Clearing, L.P. (GSEC) and two of its subsidiaries are registered U.S. broker-dealers and are regulated by the SEC, the NYSE and FINRA. Goldman Sachs Financial Markets, L.P. is registered with the SEC as an OTC derivatives dealer and conducts certain OTC derivatives businesses.

The commodity futures and commodity options industry in the United States is subject to regulation under the U.S. Commodity Exchange Act (CEA). The CFTC is the federal agency charged with the administration of the CEA. Several of Goldman Sachs' subsidiaries, including GS&Co. and GSEC, are registered with the CFTC and act as futures commission merchants, commodity pool operators or commodity trading advisors and are subject to the CEA. The rules and regulations of various self-regulatory organizations, such as the Chicago Board of Trade and the Chicago Mercantile Exchange, other futures exchanges and the National Futures Association, also govern the commodity futures and commodity options businesses of these entities.

GS&Co. and GSEC are subject to Rule 15c3-1 of the SEC and Rule 1.17 of the CFTC, which specify uniform minimum net capital requirements and also effectively require that a significant part of the registrants' assets be kept in relatively liquid form. GS&Co. and GSEC have elected to compute their minimum capital requirements in accordance with the "Alternative Net Capital Requirement" as permitted by Rule 15c3-1. As of November 2008, GS&Co. had regulatory net capital, as defined by Rule 15c3-1, of \$10.92 billion, which exceeded the amounts required by \$8.87 billion. As of November 2008, GSEC had regulatory net capital, as defined by Rule 15c3-1, of \$1.38 billion, which exceeded the amounts required by \$1.29 billion. In addition to its alternative minimum net capital requirements, GS&Co. is also required to hold tentative net capital in excess of \$1 billion and net capital in excess of \$500 million in accordance with the market and credit risk standards of Appendix E of Rule 15c3-1. GS&Co. is also required to notify the SEC in the event that its tentative net capital is less than \$5 billion. As of November 2008, GS&Co. had tentative net capital and net capital in excess of both the minimum and the notification requirements. These net capital requirements may have the effect of prohibiting these entities from distributing or withdrawing capital and may require prior notice to the SEC for certain withdrawals of capital. See Note 17 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K.

Our specialist businesses are subject to extensive regulation by a number of securities exchanges. As a Designated Market Maker on the NYSE and as a specialist on other exchanges, we are required to maintain orderly markets in the securities to which we are assigned. Under the NYSE's new Designated Market Maker rules, this may require us to supply liquidity to these markets in certain circumstances.

J. Aron & Company is authorized by the U.S. Federal Energy Regulatory Commission (FERC) to sell wholesale physical power at market-based rates. As a FERC-authorized power marketer, J. Aron & Company is subject to regulation under the U.S. Federal Power Act and FERC regulations and to the oversight of FERC. As a result of our investing activities, GS&Co. is also an "exempt holding company" under the U.S. Public Utility Holding Company Act of 2005 and applicable FERC rules.

In addition, as a result of our power-related activities, we are subject to extensive and evolving energy, environmental and other governmental laws and regulations, as discussed under "Risk Factors — Our power generation interests and related activities subject us to extensive regulation, as well as environmental and other risks associated with power generation activities" in Part I, Item 1A of our Annual Report on Form 10-K.

### **Other Regulation in the United States**

Our U.S. insurance subsidiaries are subject to state insurance regulation and oversight in the states in which they are domiciled and in the other states in which they are licensed, and we are subject to oversight as an insurance holding company in states where our insurance subsidiaries are

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domiciled. State insurance regulations limit the ability of our insurance subsidiaries to pay dividends to Group Inc. in certain circumstances, and could require regulatory approval for any change in “control” of Group Inc., which may include control of 10% or more of our voting stock. In addition, a number of our other businesses, including our lending and mortgage businesses, require us to obtain licenses, adhere to applicable regulations and be subject to the oversight of various regulators in the states in which we conduct these businesses.

The U.S. Bank Secrecy Act (BSA), as amended by the USA PATRIOT Act of 2001 (PATRIOT Act), contains anti-money laundering and financial transparency laws and mandated the implementation of various regulations applicable to all financial institutions, including standards for verifying client identification at account opening, and obligations to monitor client transactions and report suspicious activities. Through these and other provisions, the BSA and the PATRIOT Act seek to promote the identification of parties that may be involved in terrorism, money laundering or other suspicious activities. Anti-money laundering laws outside the United States contain some similar provisions. The obligation of financial institutions, including Goldman Sachs, to identify their clients, to monitor for and report suspicious transactions, to respond to requests for information by regulatory authorities and law enforcement agencies, and to share information with other financial institutions, has required the implementation and maintenance of internal practices, procedures and controls that have increased, and may continue to increase, our costs, and any failure with respect to our programs in this area could subject us to substantial liability and regulatory fines.

### **Regulation Outside the United States**

Goldman Sachs provides investment services in and from the United Kingdom under the regulation of the Financial Services Authority (FSA). Goldman Sachs International (GSI), our regulated U.K. broker-dealer, is subject to the capital requirements imposed by the FSA. As of November 2008, GSI was in compliance with the FSA capital requirements. Other subsidiaries, including Goldman Sachs International Bank, are also regulated by the FSA.

Goldman Sachs Bank (Europe) PLC (GS Bank Europe), our regulated Irish bank, is subject to minimum capital requirements imposed by the Irish Financial Services Regulatory Authority. As of November 2008, this bank was in compliance with all regulatory capital requirements. Group Inc. has issued a general guarantee of the obligations of this bank.

Various other Goldman Sachs entities are regulated by the banking, insurance and securities regulatory authorities of the European countries in which they operate, including, among others, the Federal Financial Supervisory Authority (BaFin) and the Bundesbank in Germany, Banque de France and the Autorité des Marchés Financiers in France, Banca d'Italia and the Commissione Nazionale per le Società e la Borsa (CONSOB) in Italy, the Federal Financial Markets Service in Russia and the Swiss Federal Banking Commission. Certain Goldman Sachs entities are also regulated by the European securities, derivatives and commodities exchanges of which they are members.

The investment services that are subject to oversight by the FSA and other regulators within the European Union (EU) are regulated in accordance with national laws, many of which implement EU directives requiring, among other things, compliance with certain capital adequacy standards, customer protection requirements and market conduct and trade reporting rules. These standards, requirements and rules are similarly implemented, under the same directives, throughout the EU.

Goldman Sachs Japan Co., Ltd. (GSJCL), our regulated Japanese broker-dealer, is subject to the capital requirements imposed by Japan's Financial Services Agency. As of November 2008, GSJCL was in compliance with its capital adequacy requirements. GSJCL is also regulated by the Tokyo Stock Exchange, the Osaka Securities Exchange, the Tokyo Financial Exchange, the Japan Securities Dealers Association, the Tokyo Commodity Exchange and the Ministry of Economy, Trade and Industry in Japan.



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Also in Asia, the Securities and Futures Commission in Hong Kong, the Monetary Authority of Singapore, the China Securities Regulatory Commission, the Korean Financial Supervisory Service, the Reserve Bank of India and the Securities and Exchange Board of India, among others, regulate various of our subsidiaries and also have capital standards and other requirements comparable to the rules of the SEC.

Various Goldman Sachs entities are regulated by the banking and regulatory authorities in other non-U.S. countries in which Goldman Sachs operates, including, among others, Brazil and Dubai. In addition, certain of our insurance subsidiaries are regulated by Lloyd's (which is, in turn, regulated by the FSA) and by the Bermuda Monetary Authority.

### **Regulations Applicable in and Outside the United States**

The U.S. and non-U.S. government agencies, regulatory bodies and self-regulatory organizations, as well as state securities commissions and other state regulators in the United States, are empowered to conduct administrative proceedings that can result in censure, fine, the issuance of cease and desist orders, or the suspension or expulsion of a broker-dealer or its directors, officers or employees. From time to time, our subsidiaries have been subject to investigations and proceedings, and sanctions have been imposed for infractions of various regulations relating to our activities, none of which has had a material adverse effect on us or our businesses.

The research areas of investment banks have been and remain the subject of regulatory scrutiny. The SEC and FINRA have rules governing research analysts, including rules imposing restrictions on the interaction between equity research analysts and investment banking personnel at member securities firms. Various non-U.S. jurisdictions have imposed both substantive and disclosure-based requirements with respect to research and may impose additional regulations. In 2003, GS&Co. agreed to a global settlement with certain federal and state securities regulators and self-regulatory organizations to resolve investigations into equity research analysts' alleged conflicts of interest. The global settlement includes certain restrictions and undertakings that have imposed additional costs and limitations on the conduct of our businesses, including restrictions on the interaction between research and investment banking areas.

In connection with the research settlement, we have also subscribed to a voluntary initiative imposing restrictions on the allocation of shares in initial public offerings to executives and directors of public companies. The FSA in the United Kingdom has imposed requirements on the conduct of the allocation process in equity and fixed income securities offerings (including initial public offerings and secondary distributions). The SEC, the FSA, FINRA and other U.S. or non-U.S. regulators may in the future adopt additional and more stringent rules with respect to offering procedures and the management of conflicts of interest, and we cannot fully predict the effect that any new requirements will have on our business.

Our investment management businesses are subject to significant regulation in numerous jurisdictions around the world relating to, among other things, the safeguarding of client assets and our management of client funds.

As discussed above, many of our subsidiaries are subject to regulatory capital requirements in jurisdictions throughout the world. Subsidiaries not subject to separate regulation may hold capital to satisfy local tax guidelines, rating agency requirements or internal policies, including policies concerning the minimum amount of capital a subsidiary should hold based upon its underlying risk.

Certain of our businesses are subject to compliance with regulations enacted by U.S. federal and state governments, the European Union or other jurisdictions and/or enacted by various regulatory organizations or exchanges relating to the privacy of the information of clients, employees or others, and any failure to comply with these regulations could expose us to liability and/or reputational damage.

## Item 1A. Risk Factors

We face a variety of risks that are substantial and inherent in our businesses, including market, liquidity, credit, operational, legal and regulatory risks. The following are some of the more important factors that could affect our businesses.

***Our businesses have been and may continue to be adversely affected by conditions in the global financial markets and economic conditions generally.***

Our businesses, by their nature, do not produce predictable earnings, and all of our businesses are materially affected by conditions in the global financial markets and economic conditions generally. In the past twelve months, these conditions have changed suddenly and negatively.

Since mid-2007, and particularly during the second half of 2008, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity. This was initially triggered by declines in the values of subprime mortgages, but spread to all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes, including equities. The global markets have been characterized by substantially increased volatility and short-selling and an overall loss of investor confidence, initially in financial institutions, but more recently in companies in a number of other industries and in the broader markets. The decline in asset values has caused increases in margin calls for investors, requirements that derivatives counterparties post additional collateral and redemptions by mutual and hedge fund investors, all of which have increased the downward pressure on asset values and outflows of client funds across the financial services industry. In addition, the increased redemptions and unavailability of credit have required hedge funds and others to rapidly reduce leverage, which has increased volatility and further contributed to the decline in asset values.

Market conditions have also led to the failure or merger of a number of prominent financial institutions. Financial institution failures or near-failures have resulted in further losses as a consequence of defaults on securities issued by them and defaults under bilateral derivatives and other contracts entered into with such entities as counterparties. Furthermore, declining asset values, defaults on mortgages and consumer loans, and the lack of market and investor confidence, as well as other factors, have all combined to increase credit default swap spreads, to cause rating agencies to lower credit ratings, and to otherwise increase the cost and decrease the availability of liquidity, despite very significant declines in central bank borrowing rates and other government actions. Banks and other lenders have suffered significant losses and have become reluctant to lend, even on a secured basis, due to the increased risk of default and the impact of declining asset values on the value of collateral. The markets for securitized debt offerings backed by mortgages, loans, credit card receivables and other assets have for the most part been closed.

In 2008, governments, regulators and central banks in the United States and worldwide have taken numerous steps to increase liquidity and to restore investor confidence, but asset values have continued to decline and access to liquidity continues to be very limited.

We have “long” proprietary positions in a number of our businesses. These positions are accounted for at fair value, and the declines in the values of assets have had a direct and large negative impact on our earnings in fiscal 2008. Revenues from our asset management and merchant banking businesses were also negatively impacted by declines in the values of assets managed for our clients.

The ongoing liquidity crisis and the loss of confidence in financial institutions has increased our cost of funding and limited our access to some of our traditional sources of liquidity, including both secured and unsecured borrowings. While the numerous steps taken by governments, regulators and central banks have helped reduce these funding costs somewhat and increase our access to traditional and new sources of liquidity, increases in funding costs and limitations on our access to liquidity have

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negatively impacted our earnings and our ability to engage in certain activities. In particular, in the latter half of 2008, we were unable to raise significant amounts of long-term unsecured debt in the public markets, other than as a result of the issuance of securities guaranteed by the FDIC under the TLGP. We are able to have outstanding approximately \$35 billion of debt under the TLGP that is issued prior to June 30, 2009. It is unclear when we will regain access to the public long-term unsecured debt markets on customary terms or whether any similar program will be available after the TLGP's scheduled June 2009 expiration. However, we continue to have access to short-term funding and to a number of sources of secured funding, both in the private markets and through various government and central bank sponsored initiatives. In December 2008, Moody's Investors Service downgraded our long-term debt credit rating and Standard & Poor's downgraded both our long-term and short-term debt credit ratings, in each case with an outlook of "negative."

We have been able to fund our operations during fiscal 2008. Our global core excess (our cash and cash equivalent positions maintained to ensure short-term liquidity) and our capital ratios are at levels significantly higher than in the past. Nevertheless, our credit spreads have widened and the average maturity of our new funding has decreased. Recently, we have relied to a significant extent for our long-term unsecured funding on emergency funding programs implemented by governments and central banks. It is unclear whether or for how long these facilities will be extended and what impact termination of these facilities could have on our ability to access funding. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Funding Risk" in Part II, Item 7 of our Annual Report on Form 10-K.

Furthermore, the increased riskiness of assets due to increases in the volatility of asset prices, coupled with market concerns about the levels of financial institution leverage ratios, as well as fewer attractive business opportunities, have caused us to significantly decrease the size of our balance sheet and to increase the size of our global core excess. Both of these steps may have a negative effect on our profitability, until reversed.

Concerns about financial institution profitability and solvency as a result of general market conditions, particularly in the credit markets, together with the forced merger or failure of a number of major commercial and investment banks, have at times caused a number of our clients to reduce the level of business that they do with us, either because of concerns about the safety of their assets held by us or simply arising from a desire to diversify their risk or for other reasons. Some clients have withdrawn some of the funds held at our firm or transferred them from deposits with GS Bank USA to other types of assets (in many cases leaving those assets in their brokerage accounts held with us). Some counterparties have at times refused to enter into certain derivatives and other long-term transactions with us or have requested additional collateral. These instances were more prevalent during periods when the lack of confidence in financial institutions was most widespread and have become significantly less frequent in recent months in the wake of government and central bank actions, greater understanding of client account protections and higher limits of FDIC insurance. In addition, we have acquired some new clients as a result of the difficulties experienced by other financial institutions.

During the fourth quarter of 2008, we raised \$20.75 billion in equity, comprised of a \$5.75 billion public common stock offering, a \$5 billion preferred stock and warrant issuance to Berkshire Hathaway Inc. and certain affiliates and a \$10 billion preferred stock and warrant issuance under the U.S. Treasury's TARP Capital Purchase Program. While this additional capital provides further funding to our business and we believe has improved investor perceptions with regard to our financial position, it has increased our equity and the number of actual and diluted outstanding shares of our common stock as well as our preferred dividend requirements, which will reduce our earnings per share and the return on our equity unless our earnings increase sufficiently.

In addition, as of the end of 2008, the United States, Europe and Japan are all in a recession. Business activity across a wide range of industries and regions is greatly reduced and local governments and many companies are in serious difficulty due to the lack of consumer spending and

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the lack of liquidity in the credit markets. Unemployment has increased significantly. While lower interest rates, increased volatility and substantial increases in trading volumes have positively impacted earnings in a number of our trading businesses, declines in asset values, the lack of liquidity, general uncertainty about economic and market activities and a lack of consumer, investor and CEO confidence have negatively impacted many of our other businesses, particularly our investment banking, merchant banking, asset management, credit products, mortgage, leveraged lending and equity principal strategies businesses. In particular, our investment banking business has been affected during the last twelve months by the decrease in equity and debt underwritings and the decline in both announced and completed mergers and acquisitions.

Our financial performance is highly dependent on the environment in which our businesses operate. A favorable business environment is generally characterized by, among other factors, high global gross domestic product growth, transparent, liquid and efficient capital markets, low inflation, high business and investor confidence, stable geopolitical conditions, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation, interest rates, exchange rate volatility, default rates or the price of basic commodities; outbreaks of hostilities or other geopolitical instability; corporate, political or other scandals that reduce investor confidence in capital markets; natural disasters or pandemics; or a combination of these or other factors.

Overall, during fiscal 2008, the business environment has been extremely adverse for many of our businesses and there can be no assurance that these conditions will improve in the near term. Until they do, we expect our results of operations to be adversely affected.

### ***Our businesses have been and may continue to be adversely affected by declining asset values.***

Many of our businesses, such as our merchant banking businesses, our mortgages, leveraged loan and credit products businesses in our FICC segment, and our equity principal strategies business, have net “long” positions in debt securities, loans, derivatives, mortgages, equities (including private equity) and most other asset classes. In addition, many of our market-making and other businesses in which we act as a principal to facilitate our clients’ activities, including our specialist businesses, commit large amounts of capital to maintain trading positions in interest rate and credit products, as well as currencies, commodities and equities. Because nearly all of these investing and trading positions are marked-to-market on a daily basis, declines in asset values directly and immediately impact our earnings, unless we have effectively “hedged” our exposures to such declines. In certain circumstances (particularly in the case of leveraged loans and private equities or other securities that are not freely tradable or lack established and liquid trading markets), it may not be possible or economic to hedge such exposures and to the extent that we do so the hedge may be ineffective or may greatly reduce our ability to profit from increases in the values of the assets. Sudden declines and significant volatility in the prices of assets may substantially curtail or eliminate the trading markets for certain assets, which may make it very difficult to sell, hedge or value such assets. The inability to sell or effectively hedge assets reduces our ability to limit losses in such positions and the difficulty in valuing assets may increase our risk-weighted assets which requires us to maintain additional capital and increases our funding costs.

In our specialist businesses, we are obligated by stock exchange rules to maintain an orderly market, including by purchasing shares in a declining market. In markets where asset values are declining and in volatile markets, this results in trading losses and an increased need for liquidity.

We receive asset-based management fees based on the value of our clients’ portfolios or investment in funds managed by us and, in some cases, we also receive incentive fees based on increases in the value of such investments. Declines in asset values reduce the value of our clients’ portfolios or fund assets, which in turn reduce the fees we earn for managing such assets.

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We post collateral to support our obligations and receive collateral to support the obligations of our clients and counterparties in connection with our trading businesses. When the value of the assets posted as collateral declines, the party posting the collateral may need to provide additional collateral or, if possible, reduce its trading position. A classic example of such a situation is a “margin call” in connection with a brokerage account. Therefore, declines in the value of asset classes used as collateral mean that either the cost of funding trading positions is increased or the size of trading positions is decreased. If we are the party providing collateral this can increase our costs and reduce our profitability and if we are the party receiving collateral this can also reduce our profitability by reducing the level of business done with our clients and counterparties. In addition, volatile or less liquid markets increase the difficulty of valuing assets which can lead to costly and time-consuming disputes over asset values and the level of required collateral, as well as increased credit risk to the recipient of the collateral due to delays in receiving adequate collateral.

***Our businesses have been and may continue to be adversely affected by disruptions in the credit markets, including reduced access to credit and higher costs of obtaining credit.***

Widening credit spreads, as well as significant declines in the availability of credit, have adversely affected our ability to borrow on a secured and unsecured basis and may continue to do so. We fund ourselves on an unsecured basis by issuing commercial paper, promissory notes and long-term debt, or by obtaining bank loans or lines of credit. We seek to finance many of our assets, including our less liquid assets, on a secured basis, including by entering into repurchase agreements. Disruptions in the credit markets make it harder and more expensive to obtain funding for our businesses. If our available funding is limited or we are forced to fund our operations at a higher cost, these conditions may require us to curtail our business activities and increase our cost of funding, both of which could reduce our profitability, particularly in our businesses that involve investing, lending and taking principal positions, including market making.

Our clients engaging in mergers and acquisitions often rely on access to the secured and unsecured credit markets to finance their transactions. The lack of available credit and the increased cost of credit can adversely affect the size, volume and timing of our clients’ merger and acquisition transactions — particularly large transactions — and adversely affect our financial advisory and underwriting businesses.

In addition, we may incur significant unrealized gains or losses due solely to changes in our credit spreads or those of third parties, as these changes may affect the fair value of our derivative instruments and the debt securities that we hold or issue.

***Our businesses have been and may continue to be affected by changes in the levels of market volatility.***

Certain of our trading businesses depend on market volatility to provide trading and arbitrage opportunities, and decreases in volatility may reduce these opportunities and adversely affect the results of these businesses. On the other hand, increased volatility, while it can increase trading volumes and spreads, also increases risk as measured by VaR and may expose us to increased risks in connection with our market-making and proprietary businesses or cause us to reduce the size of these businesses in order to avoid increasing our VaR. Limiting the size of our market-making positions and investing businesses can adversely affect our profitability, even though spreads are widening and we may earn more on each trade. In periods when volatility is increasing, but asset values are declining significantly (as has been the case recently), it may not be possible to sell assets at all or it may only be possible to do so at steep discounts. In such circumstances we may be forced to either take on additional risk or to incur losses in order to decrease our VaR. In addition, increases in volatility increase the level of our risk weighted assets and increase our capital requirements which increases our funding costs.

***Our businesses have been adversely affected and may continue to be adversely affected by market uncertainty or lack of confidence among investors and CEOs due to general declines in economic activity and other unfavorable economic, geopolitical or market conditions.***

Our investment banking business has been and may continue to be adversely affected by market conditions. Poor economic conditions and other adverse geopolitical conditions can adversely affect and have adversely affected investor and CEO confidence, resulting in significant industry-wide declines in the size and number of underwritings and of financial advisory transactions, which could continue to have an adverse effect on our revenues and our profit margins. In particular, because a significant portion of our investment banking revenues are derived from our participation in large transactions, a decline in the number of large transactions would adversely affect our investment banking business.

In certain circumstances, market uncertainty or general declines in market or economic activity may affect our trading businesses by decreasing levels of overall activity or by decreasing volatility, but at other times market uncertainty and even declining economic activity may result in higher trading volumes or higher spreads or both.

Market uncertainty, volatility and adverse economic conditions, as well as declines in asset values, may cause our clients to transfer their assets out of our funds or other products or their brokerage accounts and result in reduced net revenues, principally in our asset management business. To the extent that clients do not withdraw their funds, they may invest them in products that generate less fee income.

***Our investing businesses may be affected by the poor investment performance of our investment products.***

Poor investment returns in our asset management business, due to either general market conditions or underperformance (against the performance of benchmarks or of our competitors) by funds or accounts that we manage or investment products that we design or sell, affects our ability to retain existing assets and to attract new clients or additional assets from existing clients. This could affect the asset management and incentive fees that we earn on assets under management or the commissions that we earn for selling other investment products, such as structured notes or derivatives.

We have in the past provided financial support to certain of our investment products in difficult market circumstances and, at our discretion, we may decide to do so in the future for reputational or business reasons, including through equity investments or cash infusions.

***We may incur losses as a result of ineffective risk management processes and strategies.***

We seek to monitor and control our risk exposure through a risk and control framework encompassing a variety of separate but complementary financial, credit, operational, compliance and legal reporting systems, internal controls, management review processes and other mechanisms. Our trading risk management process seeks to balance our ability to profit from trading positions with our exposure to potential losses. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgments that accompany their application cannot anticipate every economic and financial outcome or the specifics and timing of such outcomes. Thus, we may, in the course of our activities, incur losses. Recent market conditions have involved unprecedented dislocations and highlight the limitations inherent in using historical data to manage risk.

The models that we use to assess and control our risk exposures reflect assumptions about the degrees of correlation or lack thereof among prices of various asset classes or other market indicators. In times of market stress or other unforeseen circumstances, such as occurred during 2008, previously uncorrelated indicators may become correlated, or conversely previously correlated indicators may move in different directions. These types of market movements have at times limited the effectiveness of our hedging strategies and have caused us to incur significant losses, and they



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may do so in the future. These changes in correlation can be exacerbated where other market participants are using risk or trading models with assumptions or algorithms that are similar to ours. In these and other cases, it may be difficult to reduce our risk positions due to the activity of other market participants or widespread market dislocations, including circumstances where asset values are declining significantly or no market exists for certain assets. To the extent that we make investments directly through various of our businesses in securities, including private equity, that do not have an established liquid trading market or are otherwise subject to restrictions on sale or hedging, we may not be able to reduce our positions and therefore reduce our risk associated with such positions. In addition, we invest our own capital in our merchant banking, alternative investment and infrastructure funds, and limitations on our ability to withdraw some or all of our investments in these funds, whether for legal, reputational or other reasons, may make it more difficult for us to control the risk exposures relating to these investments.

For a further discussion of our risk management policies and procedures, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Management” in Part II, Item 7 of our Annual Report on Form 10-K.

***Our liquidity, profitability and businesses may be adversely affected by an inability to access the debt capital markets or to sell assets or by a reduction in our credit ratings or by an increase in our credit spreads.***

Liquidity is essential to our businesses. Our liquidity may be impaired by an inability to access secured and/or unsecured debt markets, an inability to access funds from our subsidiaries, an inability to sell assets or redeem our investments, or unforeseen outflows of cash or collateral. This situation may arise due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects third parties or us, or even by the perception among market participants that we, or other market participants, are experiencing greater liquidity risk.

The financial instruments that we hold and the contracts to which we are a party are increasingly complex, as we employ structured products to benefit our clients and ourselves, and these complex structured products often do not have readily available markets to access in times of liquidity stress. Our investing activities may lead to situations where the holdings from these activities represent a significant portion of specific markets, which could restrict liquidity for our positions. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time, as is likely to occur in a liquidity or other market crisis. In addition, financial institutions with which we interact may exercise set-off rights or the right to require additional collateral, including in difficult market conditions, which could further impair our access to liquidity.

Our credit ratings are important to our liquidity. A reduction in our credit ratings could adversely affect our liquidity and competitive position, increase our borrowing costs, limit our access to the capital markets or trigger our obligations under certain bilateral provisions in some of our trading and collateralized financing contracts. Under these provisions, counterparties could be permitted to terminate contracts with Goldman Sachs or require us to post additional collateral. Termination of our trading and collateralized financing contracts could cause us to sustain losses and impair our liquidity by requiring us to find other sources of financing or to make significant cash payments or securities movements.

Our cost of obtaining long-term unsecured funding is directly related to our credit spreads (the amount in excess of the interest rate of U.S. Treasury securities (or other benchmark securities) of the same maturity that we need to pay to our debt investors). Increases in our credit spreads can significantly increase our cost of this funding. Changes in credit spreads are continuous, market-driven, and subject at times to unpredictable and highly volatile movements. Credit spreads are influenced by market perceptions of our creditworthiness. In addition, our credit spreads may be influenced by movements in the costs to purchasers of credit default swaps referenced to our

long-term debt. The market for credit default swaps is relatively new, although very large, and it has proven to be extremely volatile and currently lacks a high degree of structure or transparency.

***Group Inc. is a holding company and is dependent for liquidity on payments from its subsidiaries, which are subject to restrictions.***

Group Inc. is a holding company and, therefore, depends on dividends, distributions and other payments from its subsidiaries to fund dividend payments and to fund all payments on its obligations, including debt obligations. Many of our subsidiaries, including our broker-dealer, bank and insurance subsidiaries, are subject to laws that restrict dividend payments or authorize regulatory bodies to block or reduce the flow of funds from those subsidiaries to Group Inc. Restrictions or regulatory action of that kind could impede access to funds that Group Inc. needs to make payments on its obligations, including debt obligations, or dividend payments. In addition, Group Inc.'s right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors.

Furthermore, Group Inc. has guaranteed the payment obligations of GS&Co., GS Bank USA and GS Bank Europe, subject to certain exceptions, and has pledged significant assets to GS Bank USA to support obligations to GS Bank USA. These guarantees may require Group Inc. to provide substantial funds or assets to its subsidiaries or their creditors and counterparties at a time when Group Inc. is in need of liquidity to fund its own obligations. See "Business — Regulation" in Part I, Item 1 of our Annual Report on Form 10-K.

***Our businesses, profitability and liquidity may be adversely affected by deterioration in the credit quality of, or defaults by, third parties who owe us money, securities or other assets or whose securities or obligations we hold.***

The amount and duration of our credit exposures have been increasing over the past several years, as have the breadth and size of the entities to which we have credit exposures. We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons. A failure of a significant market participant, or even concerns about a default by such an institution, could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect us.

We are also subject to the risk that our rights against third parties may not be enforceable in all circumstances. In addition, deterioration in the credit quality of third parties whose securities or obligations we hold could result in losses and/or adversely affect our ability to rehypothecate or otherwise use those securities or obligations for liquidity purposes. A significant downgrade in the credit ratings of our counterparties could also have a negative impact on our results. While in many cases we are permitted to require additional collateral from counterparties that experience financial difficulty, disputes may arise as to the amount of collateral we are entitled to receive and the value of pledged assets. The termination of contracts and the foreclosure on collateral may subject us to claims for the improper exercise of our rights. Default rates, downgrades and disputes with counterparties as to the valuation of collateral increase significantly in times of market stress and illiquidity.

As part of our clearing business, we finance our client positions, and we could be held responsible for the defaults or misconduct of our clients. Although we regularly review credit exposures to specific clients and counterparties and to specific industries, countries and regions that we believe may present credit concerns, default risk may arise from events or circumstances that are difficult to detect or foresee.



***Concentration of risk increases the potential for significant losses.***

Concentration of risk increases the potential for significant losses in our market-making, proprietary trading, investing, block trading, merchant banking, underwriting and lending businesses. This risk may increase to the extent we expand our proprietary trading and investing businesses or commit capital to facilitate client-driven business. The number and size of such transactions may affect our results of operations in a given period. Moreover, because of concentration of risk, we may suffer losses even when economic and market conditions are generally favorable for our competitors. Disruptions in the credit markets can make it difficult to hedge these credit exposures effectively or economically. In addition, we extend large commitments as part of our credit origination activities. Our inability to reduce our credit risk by selling, syndicating or securitizing these positions, including during periods of market stress, could negatively affect our results of operations due to a decrease in the fair value of the positions, including due to the insolvency or bankruptcy of the borrower, as well as the loss of revenues associated with selling such securities or loans.

In the ordinary course of business, we may be subject to a concentration of credit risk to a particular counterparty, borrower or issuer, and a failure or downgrade of, or default by, such entity could negatively impact our businesses, perhaps materially, and the systems by which we set limits and monitor the level of our credit exposure to individual entities, industries and countries may not function as we have anticipated. While our activities expose us to many different industries and counterparties, we routinely execute a high volume of transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, and investment funds. This has resulted in significant credit concentration with respect to this industry.

***The financial services industry is highly competitive.***

The financial services industry — and all of our businesses — are intensely competitive, and we expect them to remain so. We compete on the basis of a number of factors, including transaction execution, our products and services, innovation, reputation, creditworthiness and price. Over time, there has been substantial consolidation and convergence among companies in the financial services industry. This trend accelerated over the course of the past year as a result of numerous mergers and asset acquisitions among industry participants. This trend has also hastened the globalization of the securities and other financial services markets. As a result, we have had to commit capital to support our international operations and to execute large global transactions. To the extent we expand into new business areas and new geographic regions, we will face competitors with more experience and more established relationships with clients, regulators and industry participants in the relevant market, which could adversely affect our ability to expand.

Pricing and other competitive pressures in our investment banking business, as well as our other businesses, have continued to increase, particularly in situations where some of our competitors may seek to increase market share by reducing prices. For example, in connection with investment banking and other assignments, we have experienced pressure to extend and price credit at levels that may not always fully compensate us for the risks we take.

***We face enhanced risks as new business initiatives lead us to transact with a broader array of clients and counterparties and expose us to new asset classes and new markets.***

A number of our recent and planned business initiatives and expansions of existing businesses may bring us into contact, directly or indirectly, with individuals and entities that are not within our traditional client and counterparty base and expose us to new asset classes and new markets. These business activities expose us to new and enhanced risks, including risks associated with dealing with governmental entities, reputational concerns arising from dealing with less sophisticated counterparties and investors, greater regulatory scrutiny of these activities, increased credit-related, sovereign and operational risks, risks arising from accidents or acts of terrorism, and reputational concerns with the manner in which these assets are being operated or held.

***Derivative transactions may expose us to unexpected risk and potential losses.***

We are party to a large number of derivative transactions, including credit derivatives. Many of these derivative instruments are individually negotiated and non-standardized, which can make exiting, transferring or settling the position difficult. Many credit derivatives require that we deliver to the counterparty the underlying security, loan or other obligation in order to receive payment. In a number of cases, we do not hold the underlying security, loan or other obligation and may not be able to obtain, the underlying security, loan or other obligation. This could cause us to forfeit the payments due to us under these contracts or result in settlement delays with the attendant credit and operational risk as well as increased costs to the firm.

Derivative contracts and other transactions entered into with third parties are not always confirmed by the counterparties on a timely basis. While the transaction remains unconfirmed, we are subject to heightened credit and operational risk and in the event of a default may find it more difficult to enforce the contract. In addition, as new and more complex derivative products are created, covering a wider array of underlying credit and other instruments, disputes about the terms of the underlying contracts could arise, which could impair our ability to effectively manage our risk exposures from these products and subject us to increased costs. Any regulatory effort to create an exchange or trading platform for credit derivatives and other OTC derivative contracts, or a market shift toward standardized derivatives, could reduce the risk associated with such transactions, but under certain circumstances could also limit our ability to develop derivatives that best suit the needs of our clients and ourselves and adversely affect our profitability.

***A failure in our operational systems or infrastructure, or those of third parties, could impair our liquidity, disrupt our businesses, result in the disclosure of confidential information, damage our reputation and cause losses.***

Our businesses are highly dependent on our ability to process and monitor, on a daily basis, a very large number of transactions, many of which are highly complex, across numerous and diverse markets in many currencies. These transactions, as well as the information technology services we provide to clients, often must adhere to client-specific guidelines, as well as legal and regulatory standards. As our client base and our geographical reach expands, developing and maintaining our operational systems and infrastructure becomes increasingly challenging. Our financial, accounting, data processing or other operating systems and facilities may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, such as a spike in transaction volume, adversely affecting our ability to process these transactions or provide these services. In addition, we also face the risk of operational failure, termination or capacity constraints of any of the clearing agents, exchanges, clearing houses or other financial intermediaries we use to facilitate our securities transactions, and as our interconnectivity with our clients grows, we increasingly face the risk of operational failure with respect to our clients' systems. In recent years, there has been significant consolidation among clearing agents, exchanges and clearing houses, which has increased our exposure to operational failure, termination or capacity constraints of the particular financial intermediaries that we use and could affect our ability to find adequate and cost-effective alternatives in the event of any such failure, termination or constraint. Industry consolidation, whether among market participants or financial intermediaries, increases the risk of operational failure as disparate complex systems need to be integrated, often on an accelerated basis. Furthermore, the interconnectivity of multiple financial institutions with central agents, exchanges and clearing houses increases the risk that an operational failure at one institution may cause an industry-wide operational failure that could materially impact our ability to conduct business. Any such failure, termination or constraint could adversely affect our ability to effect transactions, service our clients, manage our exposure to risk or expand our businesses or result in financial loss or liability to our clients, impairment of our liquidity, disruption of our businesses, regulatory intervention or reputational damage.

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Despite the resiliency plans and facilities we have in place, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which we are located. This may include a disruption involving electrical, communications, internet, transportation or other services used by us or third parties with which we conduct business. These disruptions may occur as a result of events that affect only our buildings or the buildings of such third parties, or as a result of events with a broader impact globally, regionally or in the cities where those buildings are located. Nearly all of our employees in our primary locations, including the New York metropolitan area, London, Frankfurt, Hong Kong, Tokyo and Bangalore, work in close proximity to one another, in one or more buildings. Notwithstanding our efforts to maintain business continuity, given that our headquarters and the largest concentration of our employees are in the New York metropolitan area, depending on the intensity and longevity of the event, a catastrophic event impacting our New York metropolitan area offices could very negatively affect our business. If a disruption occurs in one location and our employees in that location are unable to occupy our offices or communicate with or travel to other locations, our ability to service and interact with our clients may suffer, and we may not be able to successfully implement contingency plans that depend on communication or travel.

Our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software and networks may be vulnerable to unauthorized access, computer viruses or other malicious code and other events that could have a security impact. If one or more of such events occur, this potentially could jeopardize our or our clients' or counterparties' confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our, our clients', our counterparties' or third parties' operations, which could result in significant losses or reputational damage. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us.

We routinely transmit and receive personal, confidential and proprietary information by email and other electronic means. We have discussed and worked with clients, vendors, service providers, counterparties and other third parties to develop secure transmission capabilities, but we do not have, and may be unable to put in place, secure capabilities with all of our clients, vendors, service providers, counterparties and other third parties and we may not be able to ensure that these third parties have appropriate controls in place to protect the confidentiality of the information. An interception, misuse or mishandling of personal, confidential or proprietary information being sent to or received from a client, vendor, service provider, counterparty or other third party could result in legal liability, regulatory action and reputational harm.

### ***Conflicts of interest are increasing and a failure to appropriately identify and deal with conflicts of interest could adversely affect our businesses.***

As we have expanded the scope of our businesses and our client base, we increasingly must address potential conflicts of interest, including situations where our services to a particular client or our own investments or other interests conflict, or are perceived to conflict, with the interests of another client, as well as situations where one or more of our businesses have access to material non-public information that may not be shared with other businesses within the firm and situations where we may be a creditor of an entity with which we also have an advisory or other relationship.

Our regulators have the ability to scrutinize our activities for potential conflicts of interest, including through detailed examinations of specific transactions. Our status as a bank holding company subjects us to heightened regulation and increased regulatory scrutiny by the Federal Reserve Board with respect to transactions between GS Bank USA and entities that are or could be seen as affiliates of ours.

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We have extensive procedures and controls that are designed to identify and address conflicts of interest, including those designed to prevent the improper sharing of information among our businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and our reputation, which is one of our most important assets, could be damaged and the willingness of clients to enter into transactions in which such a conflict might arise may be affected if we fail, or appear to fail, to identify and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or enforcement actions.

### ***Our businesses and those of our clients are subject to extensive and pervasive regulation around the world.***

As a participant in the financial services industry, we are subject to extensive regulation in jurisdictions around the world. We face the risk of significant intervention by regulatory authorities in all jurisdictions in which we conduct our businesses. Among other things, we could be fined, prohibited from engaging in some of our business activities or subject to limitations or conditions on our business activities.

In recent years, firms in the financial services industry have been operating in a difficult regulatory environment. The industry has experienced increased scrutiny from a variety of regulators, both within and outside the United States. Penalties and fines sought by regulatory authorities have increased substantially over the last several years, and certain regulators have been more likely in recent years to commence enforcement actions.

In addition, new laws or regulations or changes in enforcement of existing laws or regulations applicable to our businesses or those of our clients may adversely affect our businesses. Recent market disruptions have led to numerous proposals for changes in the regulation of the financial services industry, including significant additional regulation. Regulatory changes could lead to business disruptions, could impact the value of assets that we hold or the scope or profitability of our business activities, could require us to change certain of our business practices and could expose us to additional costs (including compliance costs) and liabilities as well as reputational harm, and, to the extent the regulations strictly control the activities of financial services firms, make it more difficult for us to distinguish ourselves from competitors. For a discussion of the extensive regulation to which our businesses are subject, see “Business — Regulation” in Part I, Item 1 of our Annual Report on Form 10-K.

Our status as a bank holding company and the operation of our lending and other businesses through GS Bank USA subject us to additional regulation and limitations on our activities, as described in “Business — Regulation — Banking Regulation” in Part I, Item 1 of our Annual Report on Form 10-K, as well as some regulatory uncertainty as we apply banking regulations and practices to many of our businesses. The application of these regulations and practices may present us and our regulators with new or novel issues.

Our firm is subject to regulatory capital requirements at a number of levels, as described above under “Business — Regulation” in Part I, Item 1 of our Annual Report on Form 10-K. As a bank holding company, we will be subject to capital requirements based on Basel I as opposed to the requirements based on Basel II that applied to us as a CSE. Complying with these requirements may require us to liquidate assets or raise capital in a manner that adversely increases our funding costs or otherwise adversely affects our shareholders and creditors. In addition, failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on our financial condition.

### ***Our agreements with the U.S. Treasury and Berkshire Hathaway Inc. impose restrictions and obligations on us that limit our ability to increase dividends, repurchase our common stock or preferred stock and access the equity capital markets.***

In October 2008, we issued preferred stock and a warrant to purchase our common stock to the U.S. Treasury as part of its TARP Capital Purchase Program. Prior to October 28, 2011, unless we have redeemed all of the preferred stock or the U.S. Treasury has transferred all of the preferred stock to a third party, the consent of the U.S. Treasury will be required for us to, among other things,

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increase our common stock dividend or repurchase our common stock or other preferred stock (with certain exceptions, including the repurchase of our common stock to offset share dilution from equity-based employee compensation awards). We have also granted registration rights and offering facilitation rights to the U.S. Treasury and to Berkshire Hathaway Inc. pursuant to which we have agreed to lock-up periods during which we would be unable to issue equity securities.

***Substantial legal liability or significant regulatory action against us could have material adverse financial effects or cause us significant reputational harm, which in turn could seriously harm our business prospects.***

We face significant legal risks in our businesses, and the volume of claims and amount of damages and penalties claimed in litigation and regulatory proceedings against financial institutions remain high. See “Legal Proceedings” in Part I, Item 3 of our Annual Report on Form 10-K for a discussion of certain legal proceedings in which we are involved. Our experience has been that legal claims by customers and clients increase in a market downturn. In addition, employment-related claims typically increase in periods when we have reduced the total number of employees.

There have been a number of highly publicized cases involving fraud or other misconduct by employees in the financial services industry in recent years, and we run the risk that employee misconduct could occur. It is not always possible to deter or prevent employee misconduct and the precautions we take to prevent and detect this activity may not be effective in all cases.

***The growth of electronic trading and the introduction of new technology may adversely affect our business and may increase competition.***

Technology is fundamental to our business and our industry. The growth of electronic trading and the introduction of new technologies is changing our businesses and presenting us with new challenges. Securities, futures and options transactions are increasingly occurring electronically, both on our own systems and through other alternative trading systems, and it appears that the trend toward alternative trading systems will continue and probably accelerate. Some of these alternative trading systems compete with our trading businesses, including our specialist businesses, and we may experience continued competitive pressures in these and other areas. In addition, the increased use by our clients of low-cost electronic trading systems and direct electronic access to trading markets could cause a reduction in commissions and spreads. As our clients increasingly use our systems to trade directly in the markets, we may incur liabilities as a result of their use of our order routing and execution infrastructure. The NYSE’s adoption and continued refinement of its hybrid market for trading securities may increase pressure on our Equities business as clients execute more of their NYSE-related trades electronically. We have invested significant resources into the development of electronic trading systems and expect to continue to do so, but there is no assurance that the revenues generated by these systems will yield an adequate return on our investment, particularly given the relatively lower commissions arising from electronic trades.

***Our businesses may be adversely affected if we are unable to hire and retain qualified employees.***

Our performance is largely dependent on the talents and efforts of highly skilled individuals; therefore, our continued ability to compete effectively in our businesses, to manage our businesses effectively and to expand into new businesses and geographic areas depends on our ability to attract new employees and to retain and motivate our existing employees. Competition from within the financial services industry and from businesses outside the financial services industry for qualified employees has often been intense. This is particularly the case in emerging markets, where we are often competing for qualified employees with entities that have a significantly greater presence or more extensive experience in the region.



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In fiscal 2008, we significantly reduced compensation levels. In addition, the market price of our shares of our common stock declined very significantly during the year. A substantial portion of our annual bonus compensation paid to our senior employees has in recent years been paid in the form of equity-based awards. In addition, we reduced the number of employees across nearly all of our businesses during the latter portion of the year. The combination of these events could adversely affect our ability to hire and retain qualified employees.

### ***Our power generation interests and related activities subject us to extensive regulation, as well as environmental and other risks associated with power generation activities.***

The power generation facilities that we own and those that we operate, as well as our other power-related activities, are subject to extensive and evolving federal, state and local energy, environmental and other governmental laws and regulations, including environmental laws and regulations relating to, among others, air quality, water quality, waste management, natural resources, site remediation and health and safety.

We may incur substantial costs (including being required to cease or curtail operations of one or more of our power generation facilities) in complying with current or future laws and regulations relating to electric power generation and wholesale sales and trading of electricity and natural gas, including having to commit significant capital toward environmental monitoring, installation of pollution control equipment, payment of emission fees and carbon or other taxes, and application for, and holding of, permits and licenses at our power generation facilities. Our power generation facilities are also subject to the risk of unforeseen or catastrophic events, many of which are outside of our control, including breakdown or failure of power generation equipment, transmission lines or other equipment or processes or other mechanical malfunctions, performance below expected levels of output or efficiency, terrorist attacks, natural disasters or other hostile or catastrophic events. In addition, these facilities could be adversely affected by the failure of any of our third party suppliers or service providers to perform their contractual obligations, including the failure to obtain raw materials necessary for operation at reasonable prices. Market conditions or other factors could cause a failure to satisfy or obtain waivers under agreements with third parties, including lenders and utilities, which impose significant obligations on our subsidiaries that own such facilities. In addition, we may not have insurance against the risks that such facilities face or the insurance that we have may be inadequate to cover our losses.

The occurrence of any of such events may prevent the affected facilities from performing under applicable power sales agreements, may impair their operations or financial results and may result in litigation or other reputational harm.

### ***In conducting our businesses around the world, we are subject to political, economic, legal, operational and other risks that are inherent in operating in many countries.***

In conducting our businesses and maintaining and supporting our global operations, we are subject to risks of possible nationalization, expropriation, price controls, capital controls, exchange controls and other restrictive governmental actions, as well the outbreak of hostilities or acts of terrorism. In many countries, the laws and regulations applicable to the securities and financial services industries and many of the transactions in which we are involved are uncertain and evolving, and it may be difficult for us to determine the exact requirements of local laws in every market. Any determination by local regulators that we have not acted in compliance with the application of local laws in a particular market or our failure to develop effective working relationships with local regulators could have a significant and negative effect not only on our businesses in that market but also on our reputation generally. We are also subject to the enhanced risk that transactions we structure might not be legally enforceable in all cases.

Our businesses and operations are increasingly expanding into new regions throughout the world, including emerging markets, and we expect this trend to continue. Various emerging market

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countries have experienced severe economic and financial disruptions, including significant devaluations of their currencies, defaults or threatened defaults on sovereign debt, capital and currency exchange controls, and low or negative growth rates in their economies, as well as military activity or acts of terrorism. The possible effects of any of these conditions include an adverse impact on our businesses and increased volatility in financial markets generally.

***We may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic, terrorist attacks or natural disasters.***

The occurrence of unforeseen or catastrophic events, including the emergence of a pandemic or other widespread health emergency (or concerns over the possibility of such an emergency), terrorist attacks or natural disasters, could create economic and financial disruptions, could lead to operational difficulties (including travel limitations) that could impair our ability to manage our businesses, and could expose our insurance subsidiaries to significant losses.

### **Item 1B. Unresolved Staff Comments**

There are no material unresolved written comments that were received from the SEC staff 180 days or more before the end of our fiscal year relating to our periodic or current reports under the Exchange Act.

### **Item 2. Properties**

Our principal executive offices are located at 85 Broad Street, New York, New York, and comprise approximately one million rentable square feet of leased space, pursuant to a lease agreement expiring in June 2011. We also occupy over 680,000 rentable square feet at One New York Plaza under lease agreements expiring primarily in 2010 (with options to renew for up to five additional years), and we lease space at various other locations in the New York metropolitan area. In total, we lease approximately 3.7 million rentable square feet in the New York metropolitan area.

In August 2005, we leased from Battery Park City Authority a parcel of land in lower Manhattan, pursuant to a ground lease. We are currently constructing a 2.1 million gross square foot office building on the site that will serve as our headquarters. Under the lease, Battery Park City Authority holds title to all improvements, including the office building, subject to Goldman Sachs' right of exclusive possession and use until June 2069, the expiration date of the lease.

Under the terms of the ground lease, we made a lump-sum ground rent payment in June 2007 of \$161 million, which was paid into escrow, to be released to the Battery Park City Authority pending performance of specified state and city obligations. We are required to make additional periodic payments during the term of the lease. We are obligated under the ground lease to construct the office building by 2011 (subject to extensions in the case of force majeure) in accordance with certain pre-approved design standards. Construction began on the building in November 2005, and we expect construction completion and initial occupancy of the building during 2009. The building is projected to cost between \$2.1 billion and \$2.3 billion, including acquisition, development, fitout and furnishings, financing and other related costs.

We are receiving significant benefits from the City and State of New York based on our agreement to construct our headquarters in lower Manhattan. These benefits are subject to recoupment or recapture if we do not satisfy our obligations under these agreements with the City and State of New York.

We have offices at 30 Hudson Street in Jersey City, New Jersey, which we own and which include approximately 1.6 million gross square feet of office space, and we own over 575,000 square feet of additional office space spread among four locations in New York and New Jersey. We have additional offices in the U.S. and elsewhere in the Americas, which together comprise approximately 2.9 million rentable square feet of leased space.



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In Europe, the Middle East and Africa, we have offices that total approximately 2.2 million rentable square feet. Our European headquarters is located in London at Peterborough Court, pursuant to a lease expiring in 2026. In total, we lease approximately 1.6 million rentable square feet in London through various leases, relating to various properties.

In Asia, we have offices that total approximately 1.5 million rentable square feet. Our headquarters in this region are in Tokyo, at the Roppongi Hills Mori Tower, and in Hong Kong, at the Cheung Kong Center. In Tokyo, we currently lease approximately 415,000 rentable square feet, the majority of which will expire in 2018. In Hong Kong, we currently lease approximately 295,000 rentable square feet under lease agreements, the majority of which will expire in 2011.

Our occupancy expenses include costs associated with office space held in excess of our current requirements. This excess space, the cost of which is charged to earnings as incurred, is being held for potential growth or to replace currently occupied space that we may exit in the future. We regularly evaluate our current and future space capacity in relation to current and projected staffing levels. In 2008, we incurred exit costs of \$80 million related to our office space. We may incur exit costs in the future to the extent we (i) reduce our space capacity or (ii) commit to, or occupy, new properties in the locations in which we operate and, consequently, dispose of existing space that had been held for potential growth. These exit costs may be material to our results of operations in a given period.

### **Item 3. Legal Proceedings**

We are involved in a number of judicial, regulatory and arbitration proceedings (including those described below) concerning matters arising in connection with the conduct of our businesses. We believe, based on currently available information, that the results of such proceedings, in the aggregate, will not have a material adverse effect on our financial condition, but might be material to our operating results for any particular period, depending, in part, upon the operating results for such period. Given the range of litigation and investigations presently under way, our litigation expenses can be expected to remain high.

#### *IPO Process Matters*

Group Inc. and GS&Co. are among the numerous financial services companies that have been named as defendants in a variety of lawsuits alleging improprieties in the process by which those companies participated in the underwriting of public offerings in recent years.

GS&Co. has, together with other underwriters in certain offerings as well as the issuers and certain of their officers and directors, been named as a defendant in a number of related lawsuits filed in the U.S. District Court for the Southern District of New York alleging, among other things, that the prospectuses for the offerings violated the federal securities laws by failing to disclose the existence of alleged arrangements tying allocations in certain offerings to higher customer brokerage commission rates as well as purchase orders in the aftermarket, and that the alleged arrangements resulted in market manipulation. The federal district court denied a motion to dismiss in all material respects relating to the underwriter defendants and generally granted plaintiffs' motion for class certification in six "focus cases." The U.S. Court of Appeals for the Second Circuit reversed the district court's order granting class certification, denied plaintiffs' applications for rehearing and rehearing en banc, and remanded. On August 14, 2007, plaintiffs amended their complaints in the six "focus cases" as well as their master allegations for all such cases to reflect new class related allegations. On September 27, 2007, plaintiffs filed a new motion for class certification in the district court, and on November 14, 2007, GS&Co. and the other defendants moved to dismiss the amended complaints. Following a mediation, a settlement in principle has been reached, subject to negotiation of definitive documentation and court approval.

GS&Co. is among numerous underwriting firms named as defendants in a number of complaints filed commencing October 3, 2007, in the U.S. District Court for the Western District of Washington alleging violations of the federal securities laws in connection with offerings of securities for 16 issuers

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during 1999 and 2000. The complaints generally assert that the underwriters, together with each issuer's directors, officers and principal shareholders, entered into purported agreements to tie allocations in the offerings to increased brokerage commissions and aftermarket purchase orders. The complaints further allege that, based upon these and other purported agreements, the underwriters violated the reporting provisions of, and are subject to short-swing profit recovery under, Section 16 of the Exchange Act. On October 29, 2007, the cases were reassigned to a single district judge. On July 25, 2008, defendants moved to dismiss the various complaints.

GS&Co. has been named as a defendant in an action commenced on May 15, 2002 in New York Supreme Court, New York County, by an official committee of unsecured creditors on behalf of eToys, Inc., alleging that the firm intentionally underpriced eToys, Inc.'s initial public offering. The action seeks, among other things, unspecified compensatory damages resulting from the alleged lower amount of offering proceeds. The court granted GS&Co.'s motion to dismiss as to five of the claims; plaintiff appealed from the dismissal of the five claims, and GS&Co. appealed from the denial of its motion as to the remaining claim. The New York Appellate Division, First Department affirmed in part and reversed in part the lower court's ruling on the firm's motion to dismiss, permitting all claims to proceed except the claim for fraud, as to which the appellate court granted leave to replead, and the New York Court of Appeals affirmed in part and reversed in part, dismissing claims for breach of contract, professional malpractice and unjust enrichment, but permitting claims for breach of fiduciary duty and fraud to continue. On remand to the lower court, GS&Co. moved to dismiss the surviving claims or, in the alternative, for summary judgment, but the motion was denied by a decision dated March 21, 2006. Plaintiff has moved for leave to amend the complaint again, and GS&Co. has cross-moved to dismiss.

Group Inc. and certain of its affiliates have, together with various underwriters in certain offerings, received subpoenas and requests for documents and information from various governmental agencies and self-regulatory organizations in connection with investigations relating to the public offering process. Goldman Sachs has cooperated with these investigations.

### *Iridium Securities Litigation*

GS&Co. has been named as a defendant in two purported class action lawsuits commenced, beginning on May 26, 1999, in the U.S. District Court for the District of Columbia brought on behalf of purchasers of Class A common stock of Iridium World Communications, Ltd. in a January 1999 underwritten secondary offering of 7,500,000 shares of Class A common stock. All parties entered into settlement agreements, with the underwriter defendants contributing \$8.25 million to a settlement fund. The settlement was approved by the Court by order dated October 23, 2008 and has become final.

### *World Online Litigation*

Several lawsuits have been commenced in the Netherlands courts based on alleged misstatements and omissions relating to the initial public offering of World Online in March 2000. Goldman Sachs and ABN AMRO Rothschild served as joint global coordinators of the approximately €2.9 billion offering. GSI underwrote 20,268,846 shares and GS&Co. underwrote 6,756,282 shares for a total offering price of approximately €1.16 billion.

On September 11, 2000, several Dutch World Online shareholders as well as a Dutch entity purporting to represent the interests of certain World Online shareholders commenced a proceeding in Amsterdam District Court against "ABN AMRO Bank N.V., also acting under the name of ABN AMRO Rothschild," alleging misrepresentations and omissions relating to the initial public offering of World Online. The lawsuit seeks, among other things, the return of the purchase price of the shares purchased by the plaintiffs or unspecified damages. The court held that the claims failed and dismissed the complaint and the Amsterdam Court of Appeal affirmed dismissal of the complaint.

In March 2001, a Dutch shareholders association initiated legal proceedings for an unspecified amount of damages against GSI in Amsterdam District Court in connection with the World Online

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offering. The court rejected the claims against GSI, but found World Online liable in an amount to be determined. The Dutch shareholders association appealed from the dismissal of their claims against GSI. By a decision dated May 3, 2007, the Netherlands Court of Appeals affirmed in part and reversed in part the decision of the district court dismissing the complaint, holding that certain of the alleged disclosure deficiencies were actionable. On July 24, 2007, the shareholder association appealed from the Netherlands Court of Appeals decision to the extent that it affirmed the decision of the district court dismissing the complaint. On November 2, 2007, GSI joined the other defendants in appealing from the Court of Appeals decision to the extent that it reversed the district court's dismissal.

### *Research Independence Matters*

GS&Co. is one of several investment firms that have been named as defendants in substantively identical purported class actions filed in the U.S. District Court for the Southern District of New York alleging violations of the federal securities laws in connection with research coverage of certain issuers and seeking compensatory damages. In one such action, relating to coverage of RSL Communications, Inc. commenced on July 15, 2003, GS&Co.'s motion to dismiss the complaint was denied. The district court granted the plaintiffs' motion for class certification and the U.S. Court of Appeals for the Second Circuit, by an order dated January 26, 2007, vacated the district court's class certification and remanded for reconsideration.

GS&Co. is also a defendant in several actions relating to research coverage of Exodus Communications, Inc. that commenced beginning in May 2003. The actions were consolidated, Goldman, Sachs & Co.'s motion to dismiss was granted with leave to replead, and plaintiff filed a second amended complaint. The defendants' motion to dismiss the second amended complaint was granted by order dated December 4, 2007, and plaintiff's motion for reconsideration was denied by order dated June 3, 2008. Plaintiff appealed the dismissal, and while the appeal was pending, the parties entered into a settlement agreement on a non-class basis, disposing of the case.

A purported shareholder derivative action was filed in New York Supreme Court, New York County on June 13, 2003 against Group Inc. and its board of directors, which, as amended on March 3, 2004 and June 14, 2005, alleges that the directors breached their fiduciary duties in connection with the firm's research as well as the firm's IPO allocations practices.

Group Inc., GS&Co. and Henry M. Paulson, Jr., the former Chairman and Chief Executive Officer of Group Inc., have been named as defendants in a purported class action filed originally on July 18, 2003 in the U.S. District Court for the District of Nevada on behalf of purchasers of Group Inc. stock from July 1, 1999 through May 7, 2002. The complaint alleges that defendants breached their fiduciary duties and violated the federal securities laws in connection with the firm's research activities. The complaint seeks, among other things, unspecified compensatory damages and/or rescission. The action was transferred on consent to the U.S. District Court for the Southern District of New York, and the district court granted the defendants' motion to dismiss with leave to amend. Plaintiffs filed a second amended complaint, and defendants filed a motion to dismiss. In a decision dated September 29, 2006, the federal district court granted Mr. Paulson's motion to dismiss with leave to replead but otherwise denied the motion. Plaintiffs' motion for class certification was granted by a decision dated September 15, 2008, and on September 26, 2008, the Goldman Sachs defendants filed a petition in the U.S. Court of Appeals for the Second Circuit seeking review of the certification ruling.

Group Inc. and its affiliates, together with other financial services firms, have received requests for information from various governmental agencies and self-regulatory organizations in connection with their review of research independence issues. Goldman Sachs has cooperated with these requests. See "Business — Regulation — Regulations Applicable in and Outside the United States" in Part I, Item 1 of our Annual Report on Form 10-K for a discussion of our global research settlement.

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### *Enron Litigation Matters*

Goldman Sachs affiliates are defendants in certain actions relating to Enron Corp., which filed for protection under the U.S. bankruptcy laws on December 2, 2001.

GS&Co. and co-managing underwriters have been named as defendants in certain purported securities class and individual actions commenced beginning on December 14, 2001 in the U.S. District Court for the Southern District of Texas and California Superior Court brought by purchasers of \$255,875,000, (including over-allotments) of Exchangeable Notes of Enron Corp. in August 1999. The notes were mandatorily exchangeable in 2002 into shares of Enron Oil & Gas Company held by Enron Corp. or their cash equivalent. The complaints also name as defendants Group Inc. as well as certain past and present officers and directors of Enron Corp. and the company's outside accounting firm. The complaints generally allege violations of the disclosure requirements of the federal securities laws and/or state law, and seek compensatory damages. GS&Co. underwrote \$127,937,500 (including over-allotments) principal amount of the notes. Group Inc. and GS&Co. moved to dismiss the class action complaint in the Texas federal court and the motion was granted as to Group Inc. but denied as to GS&Co. One of the plaintiffs has moved for class certification. GS&Co. has moved for judgment on the pleadings against all plaintiffs. On October 18, 2007, the parties reached a settlement agreement in principle pursuant to which GS&Co. has contributed \$11.5 million to a settlement fund, subject to definitive documentation and court approval. Plaintiffs in various consolidated actions relating to Enron entered into a settlement with Banc of America Securities LLC on July 2, 2004 and with Citigroup, Inc. on June 10, 2005, including with respect to claims relating to the Exchangeable Notes offering, as to which affiliates of those settling defendants were two of the three underwriters (together with GS&Co.).

Several funds which allegedly sustained investment losses of approximately \$125 million in connection with secondary market purchases of the Exchangeable Notes as well as Zero Coupon Convertible Notes of Enron Corp. commenced an action in the U.S. District Court for the Southern District of New York on January 16, 2002. As amended, the lawsuit names as defendants the underwriters of the August 1999 offering and the company's outside accounting firm, and alleges violations of the disclosure requirements of the federal securities laws, fraud and misrepresentation. The Judicial Panel on Multidistrict Litigation has transferred that action to the Texas federal district court for purposes of coordinated or consolidated pretrial proceedings with other matters relating to Enron Corp. GS&Co. moved to dismiss the complaint and the motion was granted in part and denied in part. The district court granted the funds' motion for leave to file a second amended complaint on January 22, 2007.

GS&Co. is among numerous defendants in two substantively identical actions filed by Enron Corp.'s bankruptcy trustee in the U.S. Bankruptcy Court for the Southern District of New York beginning in November 2003 seeking to recover as fraudulent transfers and/or preferences payments made by Enron Corp. in repurchasing its commercial paper shortly before its bankruptcy filing. GS&Co., which had acted as a commercial paper dealer for Enron Corp., resold to Enron Corp. approximately \$30 million of commercial paper as principal, and as an agent facilitated Enron Corp.'s repurchase of approximately \$340 million additional commercial paper from various customers who have also been named as defendants. The bankruptcy court denied GS&Co.'s motion to dismiss as well as similar motions by other defendants. On August 1, 2005, various defendants including GS&Co. petitioned to have the denial of their motion to dismiss reviewed by the U.S. District Court for the Southern District of New York. On March 10, 2008, the district court denied GS&Co.'s motion to remove the standing reference at the present time. On April 29, 2008, GS&Co. moved for summary judgment. On January 6, 2009, GS&Co. entered into a settlement with the trustee pursuant to which it will pay \$6.95 million in exchange for a release and a bar order against any third party claims. The settlement was approved by the bankruptcy court on January 21, 2009.

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### *Exodus Securities Litigation*

By an amended complaint dated July 11, 2002, GS&Co. and the other lead underwriters for the February 2001 offering of 13,000,000 shares of common stock and \$575,000,000 of 5<sup>1</sup>/<sub>4</sub>% convertible subordinated notes of Exodus Communications, Inc. were added as defendants in a purported class action pending in the U.S. District Court for the Northern District of California. The complaint, which also names as defendants certain officers and directors of Exodus Communications, Inc., alleged violations of the disclosure requirements of the federal securities laws and seeks compensatory damages. The parties entered into a settlement agreement, with the underwriter defendants contributing \$1 million toward a settlement fund. The settlement was approved by the district court on October 31, 2008 and has become final.

### *Montana Power Litigation*

GS&Co. and Group Inc. have been named as defendants in a purported class action commenced originally on October 1, 2001 in Montana District Court, Second Judicial District on behalf of former shareholders of Montana Power Company. The complaint generally alleges that Montana Power Company violated Montana law by failing to procure shareholder approval of certain corporate strategies and transactions, that the company's board breached its fiduciary duties in pursuing those strategies and transactions, and that GS&Co. aided and abetted the board's breaches and rendered negligent advice in its role as financial advisor to the company. The complaint seeks, among other things, compensatory damages. In addition to GS&Co. and Group Inc., the defendants include Montana Power Company, certain of its officers and directors, an outside law firm for the Montana Power Company, and certain companies that purchased assets from Montana Power Company and its affiliates. The Montana state court denied the Goldman Sachs defendants' motions to dismiss. Following the bankruptcies of certain defendants in the action, defendants removed the action to federal court, the U.S. District Court for the District of Montana, Butte Division.

On October 26, 2004, a creditors committee of Touch America Holdings, Inc. brought an action against GS&Co., Group Inc., and a former outside law firm for Montana Power Company in Montana District Court, Second Judicial District. The complaint asserts that Touch America Holdings, Inc. is the successor to Montana Power Corporation and alleges substantially the same claims as in the purported class action. Defendants removed the action to federal court. Defendants moved to dismiss the complaint, but the motion was denied by a decision dated June 10, 2005.

### *Adelphia Communications Fraudulent Conveyance Litigation*

GS&Co. is among numerous entities named as defendants in two adversary proceedings commenced in the U.S. Bankruptcy Court for the Southern District of New York, one on July 6, 2003 by a creditors committee, and the second on or about July 31, 2003 by an equity committee of Adelphia Communications, Inc. Those proceedings have now been consolidated in a single amended complaint filed by the Adelphia Recovery Trust on October 31, 2007. The complaint seeks, among other things, to recover, as fraudulent conveyances, payments made allegedly by Adelphia Communications, Inc. and its affiliates to certain brokerage firms, including approximately \$62.9 million allegedly paid to GS&Co., in respect of margin calls made in the ordinary course of business on accounts owned by members of the family that formerly controlled Adelphia Communications, Inc. GS&Co. moved to dismiss the claim related to such margin payments on December 21, 2007.

### *Specialist Matters*

Spear, Leeds & Kellogg Specialists LLC (SLKS) and certain affiliates have received requests for information from various governmental agencies and self-regulatory organizations as part of an industry-wide investigation relating to activities of floor specialists in recent years. Goldman Sachs has cooperated with the requests.



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On March 30, 2004, certain specialist firms on the NYSE, including SLKS, without admitting or denying the allegations, entered into a final global settlement with the SEC and the NYSE covering certain activities during the years 1999 through 2003. The SLKS settlement involves, among other things, (i) findings by the SEC and the NYSE that SLKS violated certain federal securities laws and NYSE rules, and in some cases failed to supervise certain individual specialists, in connection with trades that allegedly disadvantaged customer orders, (ii) a cease and desist order against SLKS, (iii) a censure of SLKS, (iv) SLKS' agreement to pay an aggregate of \$45.3 million in disgorgement and a penalty to be used to compensate customers, (v) certain undertakings with respect to SLKS' systems and procedures, and (vi) SLKS' retention of an independent consultant to review and evaluate certain of SLKS' compliance systems, policies and procedures. Comparable findings were made and sanctions imposed in the settlements with other specialist firms. The settlement did not resolve the related private civil actions against SLKS and other firms or regulatory investigations involving individuals or conduct on other exchanges.

SLKS, Spear, Leeds & Kellogg, L.P. and Group Inc. are among numerous defendants named in purported class actions brought beginning in October 2003 on behalf of investors in the U.S. District Court for the Southern District of New York alleging violations of the federal securities laws and state common law in connection with NYSE floor specialist activities. The actions seek unspecified compensatory damages, restitution and disgorgement on behalf of purchasers and sellers of unspecified securities between October 17, 1998 and October 15, 2003. Plaintiffs filed a consolidated amended complaint on September 16, 2004. The defendants' motion to dismiss the amended complaint was granted in part and denied in part by a decision dated December 13, 2005. On June 28, 2007, plaintiffs filed a motion seeking to certify a class.

### *Treasury Matters*

On September 4, 2003, the SEC announced that GS&Co. had settled an administrative proceeding arising from certain trading in U.S. Treasury bonds over an approximately eight-minute period after GS&Co. received an October 31, 2001 telephone call from a Washington, D.C.-based political consultant concerning a forthcoming Treasury refunding announcement. Without admitting or denying the allegations, GS&Co. consented to the entry of an order that, among other things, (i) censured GS&Co.; (ii) directed GS&Co. to cease and desist from committing or causing any violations of Sections 15(c)(1)(A) and (C) and 15(f) of, and Rule 15c1-2 under, the Exchange Act; (iii) ordered GS&Co. to pay disgorgement and prejudgment interest in the amount of \$1,742,642, and a civil monetary penalty of \$5 million; and (iv) directed GS&Co. to conduct a review of its policies and procedures and adopt, implement and maintain policies and procedures consistent with the order and that review. GS&Co. also undertook to pay \$2,562,740 in disgorgement and interest relating to certain trading in U.S. Treasury bond futures during the same eight-minute period.

GS&Co. has been named as a defendant in a purported class action filed on March 10, 2004 in the U.S. District Court for the Northern District of Illinois on behalf of holders of short positions in 30-year U.S. Treasury futures and options on the morning of October 31, 2001. The complaint alleges that the firm purchased 30-year bonds and futures prior to the Treasury's refunding announcement that morning based on non-public information about that announcement, and that such purchases increased the costs of covering such short positions. The complaint also names as defendants the Washington, D.C.-based political consultant who allegedly was the source of the information, a former GS&Co. economist who allegedly received the information, and another company and one of its employees who also allegedly received and traded on the information prior to its public announcement. The complaint alleges violations of the federal commodities and antitrust laws, as well as Illinois statutory and common law, and seeks, among other things, unspecified damages including treble damages under the antitrust laws. The district court dismissed the antitrust and Illinois state law claims but permitted the federal commodities law claims to proceed. Plaintiff's motion for class certification was denied by a decision dated August 22, 2008. GS&Co. moved for summary judgment, and by a decision dated July 30, 2008, the district court granted the motion insofar as the remaining

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claim relates to the trading of treasury bonds, but denied the motion without prejudice to the extent the claim relates to trading of treasury futures.

### *Mutual Fund Matters*

GS&Co. and certain mutual fund affiliates have received subpoenas and requests for information from various governmental agencies and self-regulatory organizations including the SEC as part of the industry-wide investigation relating to the practices of mutual funds and their customers. GS&Co. and its affiliates have cooperated with such requests.

### *Refco Securities Litigation*

GS&Co. and the other lead underwriters for the August 2005 initial public offering of 26,500,000 shares of common stock of Refco Inc. are among the defendants in various putative class actions filed in the U.S. District Court for the Southern District of New York beginning in October 2005 by investors in Refco Inc. in response to certain publicly reported events that culminated in the October 17, 2005 filing by Refco Inc. and certain affiliates for protection under U.S. bankruptcy laws. The actions, which have been consolidated, allege violations of the disclosure requirements of the federal securities laws and seek compensatory damages. In addition to the underwriters, the consolidated complaint names as defendants Refco Inc. and certain of its affiliates, certain officers and directors of Refco Inc., Thomas H. Lee Partners, L.P. (which held a majority of Refco Inc.'s equity through certain funds it manages), Grant Thornton (Refco Inc.'s outside auditor), and BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft (BAWAG). Lead plaintiffs entered into a settlement with BAWAG, which was approved following certain amendments on June 29, 2007. GS&Co. underwrote 5,639,200 shares of common stock at a price of \$22 per share for a total offering price of approximately \$124 million.

A purported shareholder derivative action was filed in the U.S. District Court for the Southern District of New York on November 2, 2005 on behalf of Group Inc. against certain of its officers and directors. The complaint alleges that the individual defendants breached their fiduciary duties by failing to ensure that adequate due diligence was conducted in connection with the Refco Inc. initial public offering. The parties subsequently stipulated to the action's dismissal, and the action was dismissed by the district court by order dated January 7, 2009.

GS&Co. has, together with other underwriters of the Refco Inc. initial public offering, received requests for information from various governmental agencies and self-regulatory organizations. GS&Co. is cooperating with those requests.

### *Short-Selling Litigation*

Group Inc., GS&Co. and Goldman Sachs Execution & Clearing, L.P. are among the numerous financial services firms that have been named as defendants in a purported class action filed on April 12, 2006 in the U.S. District Court for the Southern District of New York by customers who engaged in short-selling transactions in equity securities since April 12, 2000. The amended complaint generally alleges that the customers were charged fees in connection with the short sales but that the applicable securities were not necessarily borrowed to effect delivery, resulting in failed deliveries, and that the defendants conspired to set a minimum threshold borrowing rate for securities designated as hard to borrow. The complaint asserts a claim under the federal antitrust laws, as well as claims under the New York Business Law and common law, and seeks treble damages as well as injunctive relief. Defendants' motion to dismiss the complaint was granted by a decision dated December 20, 2007. On January 18, 2008, plaintiffs appealed from this decision.

### *Fannie Mae Litigation*

GS&Co. was added as a defendant in an amended complaint filed on August 14, 2006 in a purported class action pending in the U.S. District Court for the District of Columbia. The complaint



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asserts violations of the federal securities laws generally arising from allegations concerning Fannie Mae's accounting practices in connection with certain Fannie Mae-sponsored REMIC transactions that were allegedly arranged by GS&Co. The other defendants include Fannie Mae, certain of its past and present officers and directors, and accountants. By a decision dated May 8, 2007, the district court granted GS&Co.'s motion to dismiss the claim against it. The time for an appeal will not begin to run until disposition of the claims against other defendants.

Beginning in September 2006, Group Inc. and/or GS&Co. were added named as defendants in four Fannie Mae shareholder derivative actions in the U.S. District Court for the District of Columbia. The complaints generally allege that the Goldman Sachs defendants aided and abetted a breach of fiduciary duty by Fannie Mae's directors and officers in connection with certain Fannie Mae-sponsored REMIC transactions and one of the complaints also asserts a breach of contract claim. The complaints also name as defendants certain former officers and directors of Fannie Mae as well as an outside accounting firm. The complaints seek, *inter alia*, unspecified damages. The Goldman Sachs defendants were dismissed without prejudice from the first filed of these actions, and the remaining claims in that action were dismissed for failure to make a demand on Fannie Mae's board of directors. That dismissal has been affirmed on appeal. The remaining three actions have been stayed by the district court.

### *General American Litigation*

On February 13, 2007, the liquidators of General American Mutual Holding Corporation filed a complaint in Missouri Circuit Court against one of the company's former officers to assert claims against Group Inc. and GS&Co. The amended complaint asserted that the Goldman Sachs defendants breached certain duties and violated Missouri law in the course of acting as the company's financial advisor during 1998-1999 in connection with the exploration of a potential demutualization and initial public offering, and the ensuing sale of certain company assets. The complaint sought compensatory and punitive damages. The parties settled the action, with the Goldman Sachs defendants paying \$99.975 million. The settlement was approved by order dated November 6, 2008.

### *Executive Compensation Litigation*

On March 16, 2007, Group Inc., its board of directors, executive officers and members of its management committee were named as defendants in a purported shareholder derivative action in the U.S. District Court for the Eastern District of New York challenging the sufficiency of the firm's February 21, 2007 Proxy Statement and the compensation of certain employees. The complaint generally alleges that the Proxy Statement undervalues stock option awards disclosed therein, that the recipients received excessive awards because the proper methodology was not followed, and that the firm's senior management received excessive compensation, constituting corporate waste. The complaint seeks, among other things, an injunction against the 2007 Annual Meeting of Shareholders, the voiding of any election of directors in the absence of an injunction and an equitable accounting for the allegedly excessive compensation. On July 20, 2007, defendants moved to dismiss the complaint, the motion was granted by an order dated December 18, 2008 and plaintiff appealed on January 13, 2009.

On January 17, 2008, Group Inc., its board of directors, executive officers and members of its management committee were named as defendants in a related purported shareholder derivative action brought by the same plaintiff in the same court predicting that the firm's 2008 Proxy Statement will violate the federal securities laws by undervaluing certain stock option awards and alleging that senior management received excessive compensation for 2007. The complaint seeks, among other things, an injunction against the distribution of the 2008 Proxy Statement, the voiding of any election

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of directors in the absence of an injunction and an equitable accounting for the allegedly excessive compensation. On January 25, 2008, the plaintiff moved for a preliminary injunction to prevent the 2008 Proxy Statement from using options valuations that the plaintiff alleges are incorrect and to require the amendment of SEC Form 4s filed by certain of the executive officers named in the complaint to reflect the stock option valuations alleged by the plaintiff. Plaintiff's motion for a preliminary injunction was denied by order dated February 14, 2008, plaintiff appealed and twice moved to expedite the appeal, with the motions being denied by orders dated February 29, 2008 and April 3, 2008.

### *Mortgage-Related Matters*

GS&Co. and certain of its affiliates, together with other financial services firms, have received requests for information from various governmental agencies and self-regulatory organizations relating to subprime mortgages, and securitizations, collateralized debt obligations and synthetic products related to subprime mortgages. GS&Co. and its affiliates are cooperating with the requests.

GS&Co., along with numerous other financial institutions, is a defendant in an action brought by the City of Cleveland alleging that the defendants' activities in connection with securitizations of subprime mortgages created a "public nuisance" in Cleveland. The action is pending in the U.S. District Court for the Northern District of Ohio, and the complaint seeks, among other things, unspecified compensatory damages. Defendants moved to dismiss on November 24, 2008.

GS&Co., Goldman Sachs Mortgage Company and GS Mortgage Securities Corp. are among the defendants in a purported class action commenced on December 11, 2008 in the U.S. District Court for the Southern District of New York brought on behalf of purchasers of various mortgage pass-through certificates and asset-backed certificates issued by various securitization trusts in 2007 and underwritten by GS&Co. The other defendants include the various issuer trusts that issued the securities as well as certain officers and directors of certain of the entity defendants. The complaint generally alleges that the registration statement and prospectus supplements for the certificates violated the federal securities laws. The complaint asserts claims against the issuer trusts and GS&Co. under Section 11 of the U.S. Securities Act of 1933 (Securities Act), and a related "controlling person" claim against the other defendants under Section 15 of the Securities Act, and seeks unspecified compensatory damages and rescission or recessionary damages.

### *Auction Products Matters*

On August 21, 2008, GS&Co. entered into a settlement in principle with the Office of Attorney General of the State of New York and the Illinois Securities Department (on behalf of the North American Securities Administrators Association) regarding auction rate securities. Under the agreement, Goldman Sachs agreed, among other things, (i) to offer to repurchase at par the outstanding auction rate securities that its private wealth management clients purchased through the firm prior to February 11, 2008, with the exception of those auction rate securities where auctions are clearing, (ii) to continue to work with issuers and other interested parties, including regulatory and governmental entities, to expeditiously provide liquidity solutions for institutional investors, and (iii) to pay a \$22.5 million fine. The settlement, which is subject to definitive documentation and approval by the various states, does not resolve any potential regulatory action by the SEC.

On August 28, 2008, a putative shareholder derivative action was filed in the U.S. District Court for the Southern District of New York naming as defendants Group Inc., its board of directors, and certain senior officers. The complaint alleges generally that the board breached its fiduciary duties and committed mismanagement in connection with its oversight of auction rate securities marketing and trading operations, that certain individual defendants engaged in insider selling by selling shares of Group Inc., and that the firm's public filings were false and misleading in violation of the federal securities laws by failing to accurately disclose the alleged practices involving auction rate securities. The complaint seeks damages, injunctive and declaratory relief, restitution, and an order requiring the firm to adopt corporate reforms. Defendants moved to dismiss on January 23, 2009.

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On September 4, 2008, Group Inc. was named as a defendant, together with numerous other financial services firms, in two complaints filed in the U.S. District Court for the Southern District of New York alleging that the defendants engaged in a conspiracy to manipulate the auction securities market in violation of federal antitrust laws. The actions were filed, respectively, on behalf of putative classes of issuers of and investors in auction rate securities and seek, among other things, treble damages. Defendants moved to dismiss on January 15, 2009.

### *Private Equity-Sponsored Acquisitions Litigation*

Group Inc. and “GS Capital Partners” are among numerous private equity firms and investment banks named as defendants in a federal antitrust action filed in the U.S. District Court for the District of Massachusetts in December 2007. As amended, the complaint generally alleges that the defendants have colluded to limit competition in bidding for private equity-sponsored acquisitions of public companies, thereby resulting in lower prevailing bids and, by extension, less consideration for shareholders of those companies in violation of Section 1 of the U.S. Sherman Antitrust Act and common law. Defendants moved to dismiss on August 27, 2008. By an order dated November 19, 2008, the district court dismissed claims relating to certain transactions that were the subject of releases as part of the settlement of shareholder actions challenging such transactions, and by an order dated December 15, 2008 otherwise denied the motion to dismiss.

### *Washington Mutual Securities Litigation*

GS&Co. is among numerous underwriters named as defendants in a putative securities class action amended complaint filed on August 5, 2008 in the U.S. District Court for the Western District of Washington. As to the underwriters, plaintiffs allege that the offering documents in connection with various securities offerings by Washington Mutual, Inc. failed to describe accurately the company’s exposure to mortgage-related activities in violation of the disclosure requirements of the federal securities laws. The defendants include past and present directors and officers of Washington Mutual, the company’s former outside auditors, and numerous underwriters. The underwriter defendants moved to dismiss on December 8, 2008. GS&Co. underwrote \$788,500,000 principal amount of securities in the offerings at issue.

On September 25, 2008, the FDIC took over the primary banking operations of Washington Mutual, Inc. and then sold them. On September 27, 2008, Washington Mutual, Inc. filed for Chapter 11 bankruptcy in the U.S. bankruptcy court in Delaware.

### *Britannia Bulk Securities Litigation*

GS&Co. is among the underwriters named as defendants in numerous putative securities class actions filed beginning on November 6, 2008 in the U.S. District Court for the Southern District of New York arising from the June 17, 2008 \$125 million initial public offering of common stock of Britannia Bulk Holdings, Inc. The complaints name as defendants the company, certain of its directors and officers, and the underwriters for the offering. Plaintiffs allege that the offering materials violated the disclosure requirements of the federal securities laws and seek compensatory damages. Defendants have yet to respond.

GS&Co. underwrote 3.75 million shares of common stock for a total offering price of \$56.25 million. The principal operating subsidiary of Britannia Bulk Holdings, Inc. is subject to an insolvency proceeding in the U.K. courts.

## **Item 4. Submission of Matters to a Vote of Security Holders**

There were no matters submitted to a vote of security holders during the fourth quarter of our fiscal year ended November 28, 2008.

## **EXECUTIVE OFFICERS OF THE GOLDMAN SACHS GROUP, INC.**

Set forth below are the name, age, present title, principal occupation and certain biographical information as of January 26, 2009 for our executive officers. All of our executive officers have been appointed by and serve at the pleasure of our board of directors.

### **Lloyd C. Blankfein, 54**

Mr. Blankfein has been our Chairman and Chief Executive Officer since June 2006, and a director since April 2003. Previously, he had been our President and Chief Operating Officer since January 2004. Prior to that, from April 2002 until January 2004, he was a Vice Chairman of Goldman Sachs, with management responsibility for Goldman Sachs' Fixed Income, Currency and Commodities Division (FICC) and Equities Division (Equities). Prior to becoming a Vice Chairman, he had served as co-head of FICC since its formation in 1997. From 1994 to 1997, he headed or co-headed the Currency and Commodities Division. Mr. Blankfein is not on the board of any public company other than Goldman Sachs. He is affiliated with certain non-profit organizations, including as a member of the Harvard University Committee on University Resources, the Advisory Board of the Tsinghua University School of Economics and Management and the Governing Board of the Indian School of Business, an overseer of the Weill Medical College of Cornell University, and a director of the Partnership for New York City and Catalyst.

### **Alan M. Cohen, 58**

Mr. Cohen has been an Executive Vice President of Goldman Sachs and our Global Head of Compliance since February 2004. From 1991 until January 2004, he was a partner in the law firm of O'Melveny & Myers LLP. He is affiliated with certain non-profit organizations, including as a board member of the New York Stem Cell Foundation.

### **Gary D. Cohn, 48**

Mr. Cohn has been our President and Co-Chief Operating Officer and a director since June 2006. Previously, he had been the co-head of Goldman Sachs' global securities businesses since January 2004. He also had been the co-head of Equities since 2003 and the co-head of FICC since September 2002. From March 2002 to September 2002, he served as co-chief operating officer of FICC. Prior to that, beginning in 1999, Mr. Cohn managed the FICC macro businesses. From 1996 to 1999, he was the global head of Goldman Sachs' commodities business. Mr. Cohn is not on the board of any public company other than Goldman Sachs. He is affiliated with certain non-profit organizations, including as a trustee of the Gilmour Academy, the NYU Child Study Center, the NYU Hospital, the NYU Medical School, the Harlem Children's Zone and American University.

### **J. Michael Evans, 51**

Mr. Evans has been a Vice Chairman of Goldman Sachs since February 2008 and chairman of Goldman Sachs Asia since 2004. Prior to becoming a Vice Chairman, he had served as global co-head of Goldman Sachs' securities business since 2003. Previously, he had been co-head of the Equities Division since 2001. Mr. Evans is a board member of CASPER (Center for Advancement of Standards-based Physical Education Reform). He also serves as a trustee of the Bendheim Center for Finance at Princeton University.

### **Gregory K. Palm, 60**

Mr. Palm has been an Executive Vice President of Goldman Sachs since May 1999, and our General Counsel and head or co-head of the Legal Department since May 1992.

**Michael S. Sherwood, 43**

Mr. Sherwood has been a Vice Chairman of Goldman Sachs since February 2008 and co-chief executive officer of Goldman Sachs International since 2005. Prior to becoming a Vice Chairman, he had served as global co-head of Goldman Sachs' securities business since 2003. Prior to that, he had been head of the Fixed Income, Currency and Commodities Division in Europe since 2001.

**Esta E. Stecher, 51**

Ms. Stecher has been an Executive Vice President of Goldman Sachs and our General Counsel and co-head of the Legal Department since December 2000. From 1994 to 2000, she was head of the firm's Tax Department, over which she continues to have senior oversight responsibility. She is also a trustee of Columbia University.

**David A. Viniar, 53**

Mr. Viniar has been an Executive Vice President of Goldman Sachs and our Chief Financial Officer since May 1999. He has been the head of Operations, Technology, Finance and Services Division since December 2002. He was head of the Finance Division and co-head of Credit Risk Management and Advisory and Firmwide Risk from December 2001 to December 2002. Mr. Viniar was co-head of Operations, Finance and Resources from March 1999 to December 2001. He was Chief Financial Officer of The Goldman Sachs Group, L.P. from March 1999 to May 1999. From July 1998 until March 1999, he was Deputy Chief Financial Officer and from 1994 until July 1998, he was head of Finance, with responsibility for Controllers and Treasury. From 1992 to 1994, he was head of Treasury and prior to that was in the Structured Finance Department of Investment Banking. He also serves on the Board of Trustees of Union College.

**John S. Weinberg, 51**

Mr. Weinberg has been a Vice Chairman of Goldman Sachs since June 2006. He has been co-head of Goldman Sachs' Investment Banking Division since December 2002. From January 2002 to December 2002, he was co-head of the Investment Banking Division in the Americas. Prior to that, he served as co-head of the Investment Banking Services Department since 1997. He is affiliated with certain non-profit organizations, including as a board member at NewYork-Presbyterian Hospital, The Steppingstone Foundation, the Greenwich Country Day School and Community Anti-Drug Coalitions of America. Mr. Weinberg also serves on the Visiting Committee for Harvard Business School.

**Jon Winkelried, 49**

Mr. Winkelried has been our President and Co-Chief Operating Officer and a director since June 2006. Previously, he had been the co-head of Goldman Sachs' Investment Banking Division since January 2005. From 2000 to 2005, he was co-head of FICC. From 1999 to 2000, he was head of FICC in Europe. From 1995 to 1999, he was responsible for Goldman Sachs' leveraged finance business. Mr. Winkelried is not on the board of any public company other than Goldman Sachs. He is also a trustee of the University of Chicago.

## PART II

### **Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The principal market on which our common stock is traded is the NYSE. Information relating to the high and low sales prices per share of our common stock, as reported by the Consolidated Tape Association, for each full quarterly period during fiscal 2007 and 2008 is set forth under the heading "Supplemental Financial Information — Common Stock Price Range" in Part II, Item 8 of our Annual Report on Form 10-K. As of January 16, 2009, there were 9,909 holders of record of our common stock.

During fiscal 2008 and 2007, dividends of \$0.35 per share of common stock were declared on December 11, 2007, March 12, 2008, June 13, 2007, September 19, 2007, December 17, 2007, March 17, 2008, June 16, 2008 and September 15, 2008. The holders of our common stock share proportionately on a per share basis in all dividends and other distributions on common stock declared by our board of directors.

The declaration of dividends by Goldman Sachs is subject to the discretion of our board of directors. Our board of directors will take into account such matters as general business conditions, our financial results, capital requirements, contractual, legal and regulatory restrictions on the payment of dividends by us to our shareholders or by our subsidiaries to us, the effect on our debt ratings and such other factors as our board of directors may deem relevant. See "Business — Regulation" in Part I, Item 1 of our Annual Report on Form 10-K for a discussion of potential regulatory limitations on our receipt of funds from our regulated subsidiaries and our payment of dividends to shareholders of Group Inc.

Prior to October 28, 2011, unless we have redeemed all the preferred stock issued to the U.S. Treasury on October 28, 2008 or unless the U.S. Treasury has transferred all the preferred stock to a third party, the consent of the U.S. Treasury will be required for us to declare or pay any dividend or make any distribution on common stock other than (i) regular quarterly cash dividends of not more than \$0.35 per share, as adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction, (ii) dividends payable solely in shares of common stock and (iii) dividends or distributions of rights or junior stock in connection with a stockholders' rights plan.



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The table below sets forth the information with respect to purchases made by or on behalf of Group Inc. or any “affiliated purchaser” (as defined in Rule 10b-18(a)(3) under the Exchange Act), of our common stock during the fourth quarter of our fiscal year ended November 28, 2008.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(2)</sup>	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs <sup>(2)</sup>
Month #1 (August 30, 2008 to September 26, 2008)	—	—	—	60,859,203
Month #2 (September 27, 2008 to October 31, 2008)	2,025	\$121.35	2,025	60,857,178
Month #3 (November 1, 2008 to November 28, 2008)	<u>4,700</u>	\$ 53.31	<u>4,700</u>	60,852,478
Total <sup>(1)</sup>	<u>6,725</u>	\$ 73.80	<u>6,725</u>	

(1) Goldman Sachs generally does not repurchase shares of its common stock as part of the repurchase program during self-imposed “black-out” periods, which run from the last two weeks of a fiscal quarter through and including the date of the earnings release for such quarter.

(2) On March 21, 2000, we announced that our board of directors had approved a repurchase program, pursuant to which up to 15 million shares of our common stock may be repurchased. This repurchase program was increased by an aggregate of 280 million shares by resolutions of our board of directors adopted on June 18, 2001, March 18, 2002, November 20, 2002, January 30, 2004, January 25, 2005, September 16, 2005, September 11, 2006 and December 17, 2007. We use our share repurchase program to help maintain the appropriate level of common equity and to substantially offset increases in share count over time resulting from employee share-based compensation. Prior to October 28, 2011, unless we have redeemed all the preferred stock issued to the U.S. Treasury on October 28, 2008 or unless the U.S. Treasury has transferred all the preferred stock to a third party, the consent of the U.S. Treasury will be required for us to repurchase our common stock in an aggregate amount greater than the increase in the number of diluted shares outstanding (as reported in our Quarterly Report on Form 10-Q for the three months ended August 29, 2008) resulting from the grant, vesting or exercise of equity-based compensation to employees and equitably adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction.

The repurchase program is effected primarily through regular open-market purchases, the amounts and timing of which are determined primarily by our current and projected capital positions (i.e., comparisons of our desired level of capital to our actual level of capital) but which may also be influenced by general market conditions and the prevailing price and trading volumes of our common stock, in each case subject to the limit imposed under the U.S. Treasury’s TARP Capital Purchase Program. The total remaining authorization under the repurchase program was 60,852,478 shares as of January 16, 2009; the repurchase program has no set expiration or termination date.

Information relating to compensation plans under which our equity securities are authorized for issuance is set forth in Part III, Item 12 of our Annual Report on Form 10-K.

## Item 6. Selected Financial Data

The Selected Financial Data table is set forth under Part II, Item 8 of our Annual Report on Form 10-K.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

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## Introduction

The Goldman Sachs Group, Inc. (Group Inc.) is a bank holding company and a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

Our activities are divided into three segments:

- **Investment Banking.** We provide a broad range of investment banking services to a diverse group of corporations, financial institutions, investment funds, governments and individuals.
- **Trading and Principal Investments.** We facilitate client transactions with a diverse group of corporations, financial institutions, investment funds, governments and individuals and take proprietary positions through market making in, trading of and investing in fixed income and equity products, currencies, commodities and derivatives on these products. In addition, we engage in market-making and specialist activities on equities and options exchanges, and we clear client transactions on major stock, options and futures exchanges worldwide. In connection with our merchant banking and other investing activities, we make principal investments directly and through funds that we raise and manage.
- **Asset Management and Securities Services.** We provide investment advisory and financial planning services and offer investment products (primarily through separately managed accounts and commingled vehicles, such as mutual funds and private investment funds) across all major asset classes to a diverse group of institutions and individuals worldwide and provide prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide.

Unless specifically stated otherwise, all references to 2008, 2007 and 2006 refer to our fiscal years ended, or the dates, as the context requires, November 28, 2008, November 30, 2007 and November 24, 2006, respectively, and any reference to a future year refers to a fiscal year ending on the last Friday in November of that year.

On December 15, 2008, the Board of Directors of Group Inc. (Board) approved a change in our fiscal year-end from the last Friday of November to the last Friday of December. The change is effective for our 2009 fiscal year. The firm's 2009 fiscal year began December 27, 2008 and will end December 25, 2009, resulting in a one-month transition period that began November 29, 2008 and ended December 26, 2008.

When we use the terms "Goldman Sachs," "the firm," "we," "us" and "our," we mean Group Inc., a Delaware corporation, and its consolidated subsidiaries. References herein to our Annual Report on Form 10-K are to our Annual Report on Form 10-K for the fiscal year ended November 28, 2008.

In this discussion, we have included statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts but instead represent only our beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside our control. These statements include statements other than historical information or statements of current condition and may relate to our future plans and objectives and results, among other things, and may also include statements about the objectives and effectiveness of our risk management and liquidity policies, statements about trends in or growth opportunities for our businesses, statements about our future status, activities or reporting under U.S. banking regulation, and statements about our investment banking transaction backlog. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause our actual results and financial condition to differ from those indicated in these forward-looking statements include, among others, those discussed below under "— Certain Risk Factors That May Affect Our Businesses" as well as "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K and "Cautionary Statement Pursuant to the U.S. Private Securities Litigation Reform Act of 1995" in Part I, Item 1 of our Annual Report on Form 10-K.

## Executive Overview

Our diluted earnings per common share were \$4.47 for 2008, compared with \$24.73 for 2007. Return on average tangible common shareholders' equity (1) was 5.5% and return on average common shareholders' equity was 4.9% for 2008. As of November 2008, book value per common share was \$98.68, an increase of 9.1% compared with the end of 2007, and our Tier 1 Ratio (2) was 15.6%. During the fourth quarter of 2008, we raised \$20.75 billion in equity, comprised of a \$5.75 billion public common stock sale, a \$5 billion preferred stock and warrant issuance to Berkshire Hathaway Inc. and certain affiliates and a \$10 billion preferred stock and warrant issuance under the U.S. Department of the Treasury's (U.S. Treasury) TARP Capital Purchase Program. Total assets were \$885 billion at the end of the year, a decrease of 21% compared with the end of 2007. During the fourth quarter of 2008, the firm became a bank holding company regulated by the Board of Governors of the Federal Reserve System (Federal Reserve Board).

Our results for 2008 reflected a particularly difficult operating environment, including significant asset price declines, high levels of volatility and reduced levels of liquidity, particularly in the fourth quarter. In addition, credit markets experienced significant dislocation between prices for cash instruments and the related derivative contracts and between credit indices and underlying single names. Net revenues in Trading and Principal Investments were significantly lower compared with 2007, reflecting significant declines in Fixed Income, Currency and Commodities (FICC), Principal Investments and Equities. The decrease in FICC primarily reflected losses in credit products, which included a loss of approximately \$3.1 billion (net of hedges) related to non-investment-grade credit origination activities and losses from investments, including corporate debt and private and public equities. Results in mortgages included net losses of approximately \$1.7 billion on residential mortgage loans and securities and approximately \$1.4 billion on commercial mortgage loans and securities. Interest rate products, currencies and commodities each produced particularly strong results and net revenues were higher compared with 2007. During 2008, although client-driven activity was generally solid, FICC operated in a challenging environment characterized by broad-based declines in asset values, wider mortgage and corporate credit spreads, reduced levels of liquidity and broad-based investor deleveraging, particularly in the second half of the year. The decline in Principal Investments primarily reflected net losses of \$2.53 billion from corporate principal investments and \$949 million from real estate principal investments, as well as a \$446 million loss from our investment in the ordinary shares of Industrial and Commercial Bank of China Limited (ICBC). In Equities, the decrease compared with particularly strong net revenues in 2007 reflected losses in principal strategies, partially offset by higher net revenues in our client franchise businesses. Commissions were particularly strong and were higher than 2007. During 2008, Equities operated in an environment characterized by a significant decline in global equity prices, broad-based investor deleveraging and very high levels of volatility, particularly in the second half of the year.

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- (1) Return on average tangible common shareholders' equity (ROTE) is computed by dividing net earnings applicable to common shareholders by average monthly tangible common shareholders' equity. See "— Results of Operations — Financial Overview" below for further information regarding our calculation of ROTE.
- (2) Before we became a bank holding company, we were subject to capital guidelines as a Consolidated Supervised Entity (CSE) that were generally consistent with those set out in the Revised Framework for the International Convergence of Capital Measurement and Capital Standards issued by the Basel Committee on Banking Supervision (Basel II). We currently compute and report our consolidated capital ratios in accordance with the Basel II requirements, as applicable to us when we were regulated as a CSE, for the purpose of assessing the adequacy of our capital. Under the Basel II framework as it applied to us when we were regulated as a CSE, our Tier 1 Ratio equals Tier 1 Capital divided by Total Risk-Weighted Assets (RWAs). We are currently working with the Federal Reserve Board to put in place the appropriate reporting and compliance mechanisms and methodologies to allow reporting of the Basel I capital ratios as of the end of March 2009. See "— Equity Capital" below for a further discussion of our Tier 1 Ratio.

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Net revenues in Investment Banking also declined significantly compared with 2007, reflecting significantly lower net revenues in both Financial Advisory and Underwriting. In Financial Advisory, the decrease compared with particularly strong net revenues in 2007 reflected a decline in industry-wide completed mergers and acquisitions. The decrease in Underwriting primarily reflected significantly lower net revenues in debt underwriting, primarily due to a decline in leveraged finance and mortgage-related activity, reflecting difficult market conditions. Net revenues in equity underwriting were slightly lower compared with 2007, reflecting a decrease in industry-wide equity and equity-related offerings. Our investment banking transaction backlog at the end of 2008 was significantly lower than it was at the end of 2007. <sup>(3)</sup>

Net revenues in Asset Management and Securities Services increased compared with 2007. Securities Services net revenues were higher, reflecting the impact of changes in the composition of securities lending customer balances, as well as higher total average customer balances. Asset Management net revenues increased slightly compared with 2007. During the year, assets under management decreased \$89 billion to \$779 billion, due to \$123 billion of market depreciation, primarily in equity assets, partially offset by \$34 billion of net inflows.

Given the difficult market conditions, and in particular, the challenging liquidity and funding environment during 2008, we focused on reducing concentrated risk positions, including our exposure to leveraged loans and real estate-related loans. We believe that the strength of our capital position will enable us to take advantage of market opportunities as they arise in 2009.

Our business, by its nature, does not produce predictable earnings. Our results in any given period can be materially affected by conditions in global financial markets and economic conditions generally. For a further discussion of the factors that may affect our future operating results, see “— Certain Risk Factors That May Affect Our Businesses” below as well as “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K.

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<sup>(3)</sup> Our investment banking transaction backlog represents an estimate of our future net revenues from investment banking transactions where we believe that future revenue realization is more likely than not.

## Business Environment

Our financial performance is highly dependent on the environment in which our businesses operate. During the first half of 2008, global economic growth slowed as the U.S. entered a recession. Despite the weakness in the U.S. and other major economies, growth in most emerging markets remained solid, which contributed to a dramatic increase in commodity prices as well as increased inflation. However, during the second half of 2008, the downturn in global economic growth became broad-based, which coincided with significant weakness and sharply reduced liquidity across global financial markets. For a further discussion of how market conditions affect our businesses, see “— Certain Risk Factors That May Affect Our Businesses” below as well as “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K. A further discussion of the business environment in 2008 is set forth below.

**Global.** Growth in the global economy weakened substantially over the course of 2008, particularly in the major economies. Economic growth in emerging markets also generally declined in 2008, but remained high relative to the major economies. Fixed income and equity markets experienced high levels of volatility, broad-based declines in asset prices and reduced levels of liquidity, particularly during the fourth quarter of our fiscal year. In addition, mortgage and corporate credit spreads widened and credit markets experienced significant dislocation between prices for cash instruments and the related derivative contracts and between credit indices and underlying single names. The U.S. Federal Reserve lowered its federal funds target rate over the course of our fiscal year, while central banks in the Eurozone, United Kingdom, Japan and China also lowered interest rates towards the end of the year. Oil prices exhibited significant volatility during our fiscal year, rising to over \$140 per barrel in July before declining to under \$60 per barrel by the end of our fiscal year. In currency markets, the U.S. dollar initially weakened against most major currencies, particularly against the Euro, but subsequently recovered as the pace of decline in global economic growth began to accelerate in the second half of the year. Investment banking activity was generally subdued during our fiscal year, reflecting a significant decline in industry-wide announced and completed mergers and acquisitions and equity and equity-related offerings compared with 2007.

**United States.** Real gross domestic product growth in the U.S. economy slowed to an estimated 1.2% in calendar year 2008, down from 2.0% in 2007. The economy entered a recession near the beginning of our fiscal year, with the downturn intensifying in our fourth quarter. Much of the slowdown was attributable to weakness in credit markets brought on by the contraction in the housing market and the associated increase in mortgage delinquencies and defaults. Growth in industrial production slowed from 2007 levels, reflecting reduced growth in domestic demand and exports. Both business and consumer confidence declined over the course of the year. Growth in consumer expenditure was supported in the first half of the year by the federal government’s stimulus package but declined thereafter, as the housing market continued to weaken and the rate of unemployment rose significantly. The rate of inflation increased during the first half of our fiscal year, as energy and food prices increased significantly, but declined sharply towards the end of the year. Measures of core inflation, which remained elevated in the first half of the year, also declined towards the end of the year as the labor market continued to weaken and capacity utilization decreased. The U.S. Federal Reserve reduced its federal funds target rate by a total of 350 basis points to 1.00% during our fiscal year, its lowest level since 2003. U.S. regulatory agencies have also taken additional measures to address reduced levels of liquidity in credit markets and the U.S. Treasury took measures to strengthen the capital adequacy of financial institutions. The yield on the 10-year U.S. Treasury note declined by 104 basis points to 2.93% during our fiscal year. The Dow Jones Industrial Average, the S&P 500 Index and the NASDAQ Composite Index ended our fiscal year lower by 34%, 39% and 42%, respectively.

**Europe.** Real gross domestic product growth in the Eurozone economies slowed to an estimated 0.8% in calendar year 2008, down from 2.6% in 2007. Growth in industrial production, fixed investment and consumer expenditure weakened throughout the year. In addition, surveys of business and consumer confidence declined. Although the labor market remained solid in the first half of the



year, the unemployment rate began to increase in the second half of the year. The rate of inflation increased during the first three quarters of the year. In response to inflationary pressures, the European Central Bank (ECB) raised interest rates in July, increasing its main refinancing operations rate by 25 basis points to 4.25%. However, during the fourth quarter of our fiscal year, the ECB lowered its main refinancing operations rate by a total of 100 basis points to 3.25%, as financial markets and the outlook for growth weakened considerably and inflationary pressures appeared to decline. In the United Kingdom, real gross domestic product growth fell to an estimated 0.9% for calendar year 2008, down from 3.0% in 2007. The decline in growth accelerated in the second half of the year as credit market conditions deteriorated and the slowdown in the U.K. housing market intensified. The rate of inflation increased during the year, although inflationary pressures appeared to moderate in our fourth quarter. The Bank of England lowered its official bank rate over the course of our fiscal year by a total of 275 basis points to 3.00%. Long-term government bond yields in both the Eurozone and the U.K. ended our fiscal year lower. The Euro and British pound depreciated by 13% and 25%, respectively, against the U.S. dollar during our fiscal year. Major European equity markets ended our fiscal year significantly lower.

**Asia.** In Japan, real gross domestic product decreased by an estimated 0.2% in calendar year 2008 compared with an increase of 2.4% in 2007. Measures of investment activity in the housing sector and growth in consumption declined during the year. Export growth remained solid in the first half of the year but deteriorated notably towards year-end as the environment outside of Japan worsened. The rate of inflation increased from the near-zero levels seen in recent years, but remained moderate. The Bank of Japan lowered its target overnight call rate by 20 basis points in October, bringing it to 0.30%, while the yield on 10-year Japanese government bonds declined by 23 basis points during our fiscal year. The yen appreciated by 14% against the U.S. dollar. The Nikkei 225 ended our fiscal year down 46%.

In China, real gross domestic product growth declined to an estimated 9.0% in calendar year 2008 from 13.0% in 2007. Export growth and industrial production decelerated rapidly toward the end of the year, while consumer spending softened but remained solid. Rising food prices contributed to a higher rate of inflation in the first half of the year but inflation fell sharply in the second half of the year. The People's Bank of China raised its one-year benchmark lending rate by 18 basis points to 7.47% at the beginning of our fiscal year, but reduced the lending rate by 189 basis points during our fourth quarter and took additional measures to increase liquidity in the financial system. The Chinese government continued to allow the steady appreciation of its currency against the U.S. dollar in the first half of the year, after which the exchange rate remained broadly unchanged. Real gross domestic product growth in India slowed to an estimated 6.7% in calendar year 2008 from 9.0% in 2007. While export growth remained solid for most of the year, growth in consumer expenditure and fixed investment declined. The rate of wholesale inflation increased sharply in the first half of the year and then subsequently declined. The Indian rupee, along with other currencies in the region, generally depreciated against the U.S. dollar. Equity markets experienced substantial declines across the region, with the Shanghai Composite Index down 62%, and markets in Hong Kong, India and South Korea also ending the year significantly lower.

**Other Markets.** Real gross domestic product growth in Brazil declined to an estimated 5.4% in calendar year 2008 from 5.7% in 2007. For most of the year, growth was supported by strong capital inflows, high demand for commodity exports, and strong domestic demand. Towards the end of the year, however, the economic outlook deteriorated, as the Brazilian currency depreciated against the U.S. dollar and commodity prices fell. In Russia, real gross domestic product growth declined to an estimated 6.2% in calendar year 2008 from 8.1% in 2007. Growth was supported by strong household consumption and increased capital investment, particularly in the first half of the year. However, in the fourth quarter, the pace of growth declined sharply, as capital outflows intensified and the Russian currency depreciated against the U.S. dollar. Brazilian and Russian equity prices ended our fiscal year significantly lower.



## Certain Risk Factors That May Affect Our Businesses

We face a variety of risks that are substantial and inherent in our businesses, including market, liquidity, credit, operational, legal and regulatory risks. For a discussion of how management seeks to manage some of these risks, see “— Risk Management” below. A summary of the more important factors that could affect our businesses follows below. For a further discussion of these and other important factors that could affect our businesses, see “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K.

**Market Conditions and Market Risk.** Our financial performance is highly dependent on the environment in which our businesses operate. Overall, during fiscal 2008, the business environment has been extremely adverse for many of our businesses and there can be no assurance that these conditions will improve in the near term.

A favorable business environment is generally characterized by, among other factors, high global gross domestic product growth, transparent, liquid and efficient capital markets, low inflation, high business and investor confidence, stable geopolitical conditions and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation, interest rates, exchange rate volatility, default rates or the price of basic commodities; outbreaks of hostilities or other geopolitical instability; corporate, political or other scandals that reduce investor confidence in capital markets; natural disasters or pandemics; or a combination of these or other factors. Our businesses and profitability have been and may continue to become adversely affected by market conditions in many ways, including the following:

- Many of our businesses, such as our merchant banking businesses, our mortgages, leveraged loan and credit products businesses in our FICC segment, and our equity principal strategies business, have net “long” positions in debt securities, loans, derivatives, mortgages, equities (including private equity) and most other asset classes. In addition, many of our market-making and other businesses in which we act as a principal to facilitate our clients’ activities, including our specialist businesses, commit large amounts of capital to maintain trading positions in interest rate and credit products, as well as currencies, commodities and equities. Because nearly all of these investing and trading positions are marked-to-market on a daily basis, declines in asset values directly and immediately impact our earnings, unless we have effectively “hedged” our exposures to such declines. In certain circumstances (particularly in the case of leveraged loans and private equities or other securities that are not freely tradable or lack established and liquid trading markets), it may not be possible or economic to hedge such exposures and to the extent that we do so the hedge may be ineffective or may greatly reduce our ability to profit from increases in the values of the assets. Sudden declines and significant volatility in the prices of assets may substantially curtail or eliminate the trading markets for certain assets, which may make it very difficult to sell, hedge or value such assets. The inability to sell or effectively hedge assets reduces our ability to limit losses in such positions and the difficulty in valuing assets may increase our risk-weighted assets which requires us to maintain additional capital and increases our funding costs.
- Our cost of obtaining long-term unsecured funding is directly related to our credit spreads. Credit spreads are influenced by market perceptions of our creditworthiness. Widening credit spreads, as well as significant declines in the availability of credit, have adversely affected our ability to borrow on a secured and unsecured basis and may continue to do so. We fund ourselves on an unsecured basis by issuing commercial paper, promissory notes and long-term debt, or by obtaining bank loans or lines of credit. We seek to finance many of our assets, including our less liquid assets, on a secured basis, including by entering into repurchase agreements. Disruptions in the credit markets make it harder and more expensive to obtain funding for our businesses. If our available funding is limited or we are forced to fund

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our operations at a higher cost, these conditions may require us to curtail our business activities and increase our cost of funding, both of which could reduce our profitability, particularly in our businesses that involve investing, lending and taking principal positions, including market making.

- Our investment banking business has been and may continue to be adversely affected by market conditions. Poor economic conditions and other adverse geopolitical conditions can adversely affect and have adversely affected investor and CEO confidence, resulting in significant industry-wide declines in the size and number of underwritings and of financial advisory transactions, which could continue to have an adverse effect on our revenues and our profit margins. In addition, our clients engaging in mergers and acquisitions often rely on access to the secured and unsecured credit markets to finance their transactions. The lack of available credit and the increased cost of credit can adversely affect the size, volume and timing of our clients' merger and acquisition transactions — particularly large transactions. Because a significant portion of our investment banking revenues are derived from our participation in large transactions, a decline in the number of large transactions would adversely affect our investment banking business.
- Certain of our trading businesses depend on market volatility to provide trading and arbitrage opportunities, and decreases in volatility may reduce these opportunities and adversely affect the results of these businesses. On the other hand, increased volatility, while it can increase trading volumes and spreads, also increases risk as measured by VaR and may expose us to increased risks in connection with our market-making and proprietary businesses or cause us to reduce the size of these businesses in order to avoid increasing our VaR. Limiting the size of our market-making positions and investing businesses can adversely affect our profitability.
- We receive asset-based management fees based on the value of our clients' portfolios or investment in funds managed by us and, in some cases, we also receive incentive fees based on increases in the value of such investments. Declines in asset values reduce the value of our clients' portfolios or fund assets, which in turn reduce the fees we earn for managing such assets. Market uncertainty, volatility and adverse economic conditions, as well as declines in asset values, may cause our clients to transfer their assets out of our funds or other products or their brokerage accounts or affect our ability to attract new clients or additional assets from existing clients and result in reduced net revenues, principally in our asset management business. To the extent that clients do not withdraw their funds, they may invest them in products that generate less fee income.
- Concentration of risk increases the potential for significant losses in our market-making, proprietary trading, investing, block trading, merchant banking, underwriting and lending businesses. This risk may increase to the extent we expand our proprietary trading and investing businesses or commit capital to facilitate customer-driven business.
- Concerns about financial institution profitability and solvency as a result of general market conditions, particularly in the credit markets, together with the forced merger or failure of a number of major commercial and investment banks have at times caused a number of our clients to reduce the level of business that they do with us, either because of concerns about the safety of their assets held by us or simply arising from a desire to diversify their risk or for other reasons. Some clients have withdrawn some of the funds held at our firm or transferred them from deposits with GS Bank USA to other types of assets (in many cases leaving those assets in their brokerage accounts held with us). Some counterparties have at times refused to enter into certain derivatives and other long-term transactions with us or have requested additional collateral. These instances were more prevalent during periods when the lack of confidence in financial institutions was most widespread and have become significantly less frequent in recent months.

**Liquidity Risk.** Liquidity is essential to our businesses. Our liquidity may be impaired by an inability to access secured and/or unsecured debt markets, an inability to access funds from our subsidiaries, an inability to sell assets or redeem our investments, or unforeseen outflows of cash or collateral. This situation may arise due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects third parties or us, or even by the perception among market participants that we, or other market participants, are experiencing greater liquidity risk. The ongoing liquidity crisis and the loss of confidence in financial institutions has increased our cost of funding and limited our access to some of our traditional sources of liquidity, including both secured and unsecured borrowings. In particular, in the latter half of 2008, we were unable to raise significant amounts of long-term unsecured debt in the public markets, other than as a result of the issuance of securities guaranteed by the Federal Deposit Insurance Corporation (FDIC) under the FDIC's Temporary Liquidity Guarantee Program (TLGP). It is unclear when we will regain access to the public long-term unsecured debt markets on customary terms or whether any similar program will be available after the TLGP's scheduled June 2009 expiration.

The financial instruments that we hold and the contracts to which we are a party are increasingly complex, as we employ structured products to benefit our clients and ourselves, and these complex structured products often do not have readily available markets to access in times of liquidity stress. Our investing activities may lead to situations where the holdings from these activities represent a significant portion of specific markets, which could restrict liquidity for our positions. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time, as is likely to occur in a liquidity or other market crisis. In addition, financial institutions with which we interact may exercise set-off rights or the right to require additional collateral, including in difficult market conditions, which could further impair our access to liquidity.

Our credit ratings are important to our liquidity. A reduction in our credit ratings could adversely affect our liquidity and competitive position, increase our borrowing costs, limit our access to the capital markets or trigger our obligations under certain bilateral provisions in some of our trading and collateralized financing contracts. Under these provisions, counterparties could be permitted to terminate contracts with Goldman Sachs or require us to post additional collateral. Termination of our trading and collateralized financing contracts could cause us to sustain losses and impair our liquidity by requiring us to find other sources of financing or to make significant cash payments or securities movements. For a discussion of downgrades to our ratings that occurred in December 2008 and of the potential impact on Goldman Sachs of a further reduction in our credit ratings, see "— Liquidity and Funding Risk — Credit Ratings" below.

Group Inc. has guaranteed the payment obligations of Goldman, Sachs & Co. (GS&Co.), Goldman Sachs Bank USA (GS Bank USA) and Goldman Sachs Bank (Europe) PLC (GS Bank Europe), subject to certain exceptions, and has pledged significant assets to GS Bank USA to support its obligations to GS Bank USA. These guarantees may require Group Inc. to provide substantial funds or assets to its subsidiaries or their creditors or counterparties at a time when Group Inc. is in need of liquidity to fund its own obligations.

**Credit Risk.** The amount and duration of our credit exposures have been increasing over the past several years, as have the breadth and size of the entities to which we have credit exposures. We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons. A failure of a significant market participant, or even concerns about a default by such an institution, could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect us. We are also subject to the risk that our rights against third parties may not be enforceable in all circumstances. In addition, deterioration in the credit quality of third parties whose securities or obligations we hold could result in losses and/or adversely affect our ability to rehypothecate or otherwise use those securities or obligations for liquidity purposes. A significant downgrade in the credit ratings of our counterparties could also have a negative impact on our results. While in many cases we are permitted to require additional collateral for counterparties that experience financial difficulty, disputes may arise as to the amount of collateral we are entitled to receive and the value of pledged assets. Default rates, downgrades and disputes with counterparties as to the valuation of collateral increase significantly in times of market stress and illiquidity.

As part of our clearing business, we finance our client positions, and we could be held responsible for the defaults or misconduct of our clients. Although we regularly review credit exposures to specific clients and counterparties and to specific industries, countries and regions that we believe may present credit concerns, default risk may arise from events or circumstances that are difficult to detect or foresee, particularly as new business initiatives lead us to transact with a broader array of clients and counterparties and expose us to new asset classes and new markets.

We have experienced, due to competitive factors, pressure to extend and price credit at levels that may not always fully compensate us for the risks we take. In particular, corporate clients sometimes seek to require credit commitments from us in connection with investment banking and other assignments.

**Operational Risk.** Our businesses are highly dependent on our ability to process and monitor, on a daily basis, a very large number of transactions, many of which are highly complex, across numerous and diverse markets in many currencies. These transactions, as well as the information technology services we provide to clients, often must adhere to client-specific guidelines, as well as legal and regulatory standards. Despite the resiliency plans and facilities we have in place, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which we are located. This may include a disruption involving electrical, communications, internet, transportation or other services used by us or third parties with which we conduct business.

Industry consolidation, whether among market participants or financial intermediaries, increases the risk of operational failure as disparate complex systems need to be integrated, often on an accelerated basis. Furthermore, the interconnectivity of multiple financial institutions with central agents, exchanges and clearing houses increases the risk that an operational failure at one institution may cause an industry-wide operational failure that could materially impact our ability to conduct business.

**Legal and Regulatory Risk.** We are subject to extensive and evolving regulation in jurisdictions around the world. Several of our subsidiaries are subject to regulatory capital requirements and, as a bank holding company, we are subject to minimum capital standards and a minimum Tier 1 leverage ratio on a consolidated basis. Firms in the financial services industry have been operating in a difficult regulatory environment. Recent market disruptions have led to numerous proposals for significant additional regulation of the financial services industry. These regulations could limit our business activities, increase compliance costs and, to the extent the regulations strictly control the activities of financial services firms, make it more difficult for us to distinguish ourselves from competitors. Substantial legal liability or a significant regulatory action against us could have material adverse financial effects or cause significant reputational harm to us, which in turn could seriously harm our business prospects. As a bank holding company, we will be subject to capital requirements based on Basel I as opposed to the requirements based on Basel II that applied to us as a CSE. Complying with these requirements may require us to liquidate assets or raise capital in a manner that adversely increases our funding costs or otherwise adversely affects our shareholders and creditors. In addition, failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on our financial condition. Our status as a bank holding company and the operation of our lending and other businesses through GS Bank USA subject us to additional regulation and limitations on our activities, as described in “Regulation — Banking Regulation” in Part I, Item 1 of our Annual Report on Form 10-K, as well as some regulatory uncertainty as we apply banking regulations and practices to many of our businesses. The application of these regulations and practices may present us and our regulators with new or novel issues. We face significant legal risks in our businesses, and the volume of claims and amount of damages and penalties claimed in litigation and regulatory proceedings against financial institutions remain high. Our experience has been that legal claims by customers and clients increase in a market downturn. In addition, employment-related claims typically increase in periods when we have reduced the total number of employees. For a discussion of how we account for our legal and regulatory exposures, see “— Use of Estimates” below.

## Critical Accounting Policies

### Fair Value

The use of fair value to measure financial instruments, with related unrealized gains or losses generally recognized in “Trading and principal investments” in our consolidated statements of earnings, is fundamental to our financial statements and our risk management processes and is our most critical accounting policy. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Financial assets are marked to bid prices and financial liabilities are marked to offer prices.

During the fourth quarter of 2008, both the Financial Accounting Standards Board (FASB) and the staff of the SEC re-emphasized the importance of sound fair value measurement in financial reporting. In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active.” This statement clarifies that determining fair value in an inactive or dislocated market depends on facts and circumstances and requires significant management judgment. This statement specifies that it is acceptable to use inputs based on management estimates or assumptions, or for management to make adjustments to observable inputs to determine fair value when markets are not active and relevant observable inputs are not available. Our fair value measurement policies are consistent with the guidance in FSP No. FAS 157-3.

Substantially all trading assets and trading liabilities are reflected in our consolidated statements of financial condition at fair value, pursuant principally to:

- Statement of Financial Accounting Standards (SFAS) No. 115, “Accounting for Certain Investments in Debt and Equity Securities;”
- specialized industry accounting for broker-dealers and investment companies;
- SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities;” or
- the fair value option under either SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments — an amendment of FASB Statements No. 133 and 140,” or SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (i.e., the fair value option).

Upon becoming a bank holding company in September 2008, we could no longer apply specialized broker-dealer industry accounting to those subsidiaries not regulated as broker-dealers. Therefore, within our non-broker-dealer subsidiaries, we designated as held for trading those instruments within the scope of SFAS No. 115 (i.e., debt securities and marketable equity securities), and elected the fair value option for other cash instruments (specifically loans, loan commitments and certain private equity and restricted public equity securities) which we historically had carried at fair value. These fair value elections were in addition to previous elections made for certain corporate loans, loan commitments and certificates of deposit issued by GS Bank USA. There was no impact on earnings from these initial elections because all of these instruments were already recorded at fair value in “Trading assets, at fair value” or “Trading liabilities, at fair value” in the consolidated statements of financial condition prior to Group Inc. becoming a bank holding company.

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In determining fair value, we separate our “Trading assets, at fair value” and “Trading liabilities, at fair value” into two categories: cash instruments and derivative contracts, as set forth in the following table:

### Trading Instruments by Category (in millions)

	As of November			
	2008		2007	
	Trading Assets, at Fair Value	Trading Liabilities, at Fair Value	Trading Assets, at Fair Value	Trading Liabilities, at Fair Value
Cash trading instruments	\$186,231	\$ 57,143	\$324,181	\$ 112,018
ICBC	5,496 (1)	—	6,807 (1)	—
SMFG	1,135	1,134 (4)	4,060	3,627 (4)
Other principal investments	15,126 (2)	—	11,933 (2)	—
Principal investments	21,757	1,134	22,800	3,627
Cash instruments	207,988	58,277	346,981	115,645
Exchange-traded	6,164	8,347	13,541	12,280
Over-the-counter	124,173	109,348	92,073	87,098
Derivative contracts	130,337 (3)	117,695 (5)	105,614 (3)	99,378 (5)
Total	<u>\$338,325</u>	<u>\$175,972</u>	<u>\$452,595</u>	<u>\$215,023</u>

(1) Includes interests of \$3.48 billion and \$4.30 billion as of November 2008 and November 2007, respectively, held by investment funds managed by Goldman Sachs. The fair value of our investment in the ordinary shares of ICBC, which trade on The Stock Exchange of Hong Kong, includes the effect of foreign exchange revaluation for which we maintain an economic currency hedge.

(2) The following table sets forth the principal investments (in addition to our investments in ICBC and Sumitomo Mitsui Financial Group, Inc. (SMFG)) included within the Principal Investments component of our Trading and Principal Investments segment:

	As of November			
	2008		2007	
	Corporate	Real Estate Total	Corporate	Real Estate Total
	(in millions)			
Private	\$10,726	\$2,935	\$13,661	\$7,297
Public	1,436	29	2,208	67
Total	<u>\$12,162</u>	<u>\$2,964</u>	<u>\$15,126</u>	<u>\$9,505</u>

(3) Net of cash received pursuant to credit support agreements of \$137.16 billion and \$59.05 billion as of November 2008 and November 2007, respectively.

(4) Represents an economic hedge on the shares of common stock underlying our investment in the convertible preferred stock of SMFG.

(5) Net of cash paid pursuant to credit support agreements of \$34.01 billion and \$27.76 billion as of November 2008 and November 2007, respectively.



**Cash Instruments.** Cash instruments include cash trading instruments, public principal investments and private principal investments.

- **Cash Trading Instruments.** Our cash trading instruments are generally valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include most U.S. government and sovereign obligations, active listed equities and certain money market securities.

The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most government agency securities, investment-grade corporate bonds, certain mortgage products, certain bank loans and bridge loans, less liquid listed equities, state, municipal and provincial obligations and certain money market securities and loan commitments.

Certain cash trading instruments trade infrequently and therefore have little or no price transparency. Such instruments include private equity and real estate fund investments, certain bank loans and bridge loans (including certain mezzanine financing, leveraged loans arising from capital market transactions and other corporate bank debt), less liquid corporate debt securities and other debt obligations (including less liquid high-yield corporate bonds, distressed debt instruments and collateralized debt obligations (CDOs) backed by corporate obligations), less liquid mortgage whole loans and securities (backed by either commercial or residential real estate), and acquired portfolios of distressed loans. The transaction price is initially used as the best estimate of fair value. Accordingly, when a pricing model is used to value such an instrument, the model is adjusted so that the model value at inception equals the transaction price. This valuation is adjusted only when changes to inputs and assumptions are corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows.

For positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability. Such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

- **Public Principal Investments.** Our public principal investments held within the Principal Investments component of our Trading and Principal Investments segment tend to be large, concentrated holdings resulting from initial public offerings or other corporate transactions, and are valued based on quoted market prices. For positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability. Such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

Our most significant public principal investment is our investment in the ordinary shares of ICBC. Our investment in ICBC is valued using the quoted market price adjusted for transfer restrictions. The ordinary shares acquired from ICBC are subject to transfer restrictions that, among other things, prohibit any sale, disposition or other transfer until April 28, 2009. From April 28, 2009 to October 20, 2009, we may transfer up to 50% of the aggregate ordinary shares of ICBC that we owned as of October 20, 2006. We may transfer the remaining shares after October 20, 2009. A portion of our interest is held by investment funds managed by Goldman Sachs.

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We also have an investment in the convertible preferred stock of SMFG. This investment is valued using a model that is principally based on SMFG's common stock price. During our second quarter of 2008, we converted one-third of our SMFG preferred stock investment into SMFG common stock, and delivered the common stock to close out one-third of our hedge position. As of November 2008, we remained hedged on the common stock underlying our remaining investment in SMFG.

- **Private Principal Investments.** Our private principal investments held within the Principal Investments component of our Trading and Principal Investments segment include investments in private equity, debt and real estate, primarily held through investment funds. By their nature, these investments have little or no price transparency. We value such instruments initially at transaction price and adjust valuations when evidence is available to support such adjustments. Such evidence includes transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows.

**Derivative Contracts.** Derivative contracts can be exchange-traded or over-the-counter (OTC). We generally value exchange-traded derivatives using models which calibrate to market-clearing levels and eliminate timing differences between the closing price of the exchange-traded derivatives and their underlying instruments.

OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market-clearing transactions, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Where models are used, the selection of a particular model to value an OTC derivative depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. We generally use similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment.

Certain OTC derivatives trade in less liquid markets with limited pricing information, and the determination of fair value for these derivatives is inherently more difficult. Where we do not have corroborating market evidence to support significant model inputs and cannot verify the model to market transactions, the transaction price is initially used as the best estimate of fair value. Accordingly, when a pricing model is used to value such an instrument, the model is adjusted so that the model value at inception equals the transaction price. Subsequent to initial recognition, we only update valuation inputs when corroborated by evidence such as similar market transactions, third-party pricing services and/or broker or dealer quotations, or other empirical market data. In circumstances where we cannot verify the model value to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value. See “— Derivatives” below for further information on our OTC derivatives.

When appropriate, valuations are adjusted for various factors such as liquidity, bid/offer spreads and credit considerations. Such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

**Controls Over Valuation of Financial Instruments.** A control infrastructure, independent of the trading and investing functions, is fundamental to ensuring that our financial instruments are appropriately valued at market-clearing levels (exit price) and that fair value measurements are reliable and consistently determined.

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We employ an oversight structure that includes appropriate segregation of duties. Senior management, independent of the trading and investing functions, is responsible for the oversight of control and valuation policies and for reporting the results of these policies to our Audit Committee. We seek to maintain the necessary resources to ensure that control functions are performed appropriately. We employ procedures for the approval of new transaction types and markets, price verification, review of daily profit and loss, and review of valuation models by personnel with appropriate technical knowledge of relevant products and markets. These procedures are performed by personnel independent of the trading and investing functions. For financial instruments where prices or valuations that require inputs are less observable, we employ, where possible, procedures that include comparisons with similar observable positions, analysis of actual to projected cash flows, comparisons with subsequent sales, reviews of valuations used for collateral management purposes and discussions with senior business leaders. See “— Market Risk” and “— Credit Risk” below for a further discussion of how we manage the risks inherent in our trading and principal investing businesses.

**Fair Value Hierarchy — Level 3.** SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The objective of a fair value measurement is to determine the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Instruments that trade infrequently and therefore have little or no price transparency are classified within level 3 of the fair value hierarchy. We determine which instruments are classified within level 3 based on the results of our price verification process. This process is performed by personnel independent of our trading and investing functions who corroborate valuations to external market data (e.g., quoted market prices, broker or dealer quotations, third-party pricing vendors, recent trading activity and comparative analyses to similar instruments). When broker or dealer quotations or third-party pricing vendors are used for valuation or price verification, greater priority is given to executable quotes. As part of our price verification process, valuations based on quotes are corroborated by comparison both to other quotes and to recent trading activity in the same or similar instruments. The number of quotes obtained varies by instrument and depends on the liquidity of the particular instrument. See Notes 2 and 3 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding SFAS No. 157.

Recent market conditions, particularly in the fourth quarter of 2008 (characterized by dislocations between asset classes, elevated levels of volatility, and reduced price transparency), have increased the level of management judgment required to value cash trading instruments classified within level 3 of the fair value hierarchy. In particular, management’s judgment is required to determine the appropriate risk-adjusted discount rate for cash trading instruments with little or no price transparency as a result of decreased volumes and lower levels of trading activity. In such situations, our valuation is adjusted to approximate rates which market participants would likely consider appropriate for relevant credit and liquidity risks.

**Valuation Methodologies for Level 3 Assets.** Instruments classified within level 3 of the fair value hierarchy are initially valued at transaction price, which is considered to be the best initial estimate of fair value. As time passes, transaction price becomes less reliable as an estimate of fair value and accordingly, we use other methodologies to determine fair value, which vary based on the type of instrument, as described below. Regardless of the methodology, valuation inputs and assumptions are only changed when corroborated by substantive evidence. Senior management in control functions, independent of the trading and investing functions, reviews all significant unrealized gains/losses, including the primary drivers of the change in value. Valuations are further corroborated by values realized upon

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sales of our level 3 assets. An overview of methodologies used to value our level 3 assets subsequent to the transaction date is as follows:

- **Private equity and real estate fund investments.** Investments are generally held at cost for the first year. Recent third-party investments or pending transactions are considered to be the best evidence for any change in fair value. In the absence of such evidence, valuations are based on third-party independent appraisals, transactions in similar instruments, discounted cash flow techniques, valuation multiples and public comparables. Such evidence includes pending reorganizations (e.g., merger proposals, tender offers or debt restructurings); and significant changes in financial metrics (e.g., operating results as compared to previous projections, industry multiples, credit ratings and balance sheet ratios).
- **Bank loans and bridge loans and Corporate debt securities and other debt obligations.** Valuations are generally based on discounted cash flow techniques, for which the key inputs are the amount and timing of expected future cash flows, market yields for such instruments and recovery assumptions. Inputs are generally determined based on relative value analyses, which incorporate comparisons both to credit default swaps that reference the same underlying credit risk and to other debt instruments for the same issuer for which observable prices or broker quotes are available.
- **Loans and securities backed by commercial real estate.** Loans and securities backed by commercial real estate are collateralized by specific assets and are generally tranching into varying levels of subordination. Due to the nature of these instruments, valuation techniques vary by instrument. Methodologies include relative value analyses across different tranches, comparisons to transactions in both the underlying collateral and instruments with the same or substantially the same underlying collateral, market indices (such as the CMBX (1)), and credit default swaps, as well as discounted cash flow techniques.
- **Loans and securities backed by residential real estate.** Valuations are based on both proprietary and industry recognized models (including Intex and Bloomberg), discounted cash flow techniques and hypothetical securitization analyses. In the recent market environment, the most significant inputs to the valuation of these instruments are rates of delinquency, default and loss expectations, which are driven in part by housing prices. Inputs are determined based on relative value analyses, which incorporate comparisons to instruments with similar collateral and risk profiles, including relevant indices such as the ABX (1).
- **Loan portfolios.** Valuations are based on discounted cash flow techniques, for which the key inputs are the amount and timing of expected future cash flows and market yields for such instruments. Inputs are determined based on relative value analyses which incorporate comparisons to recent auction data for other similar loan portfolios.
- **Derivative contracts.** Valuation models are calibrated to initial transaction price. Subsequent changes in valuations are based on observable inputs to the valuation models (e.g., interest rates, credit spreads, volatilities, etc.). Inputs are changed only when corroborated by market data. Valuations of less liquid OTC derivatives are typically based on level 1 or level 2 inputs that can be observed in the market, as well as unobservable inputs, such as correlations and volatilities.

Total level 3 assets were \$66.19 billion and \$69.15 billion as of November 2008 and November 2007, respectively. The decrease in level 3 assets for the year ended November 2008 primarily reflected (i) unrealized losses on loans and securities backed by commercial real estate, bank loans and bridge loans, and private equity and real estate fund investments, and (ii) sales and paydowns on bank loans and bridge loans and loan portfolios. These decreases were partially offset by transfers to level 3 of certain loans and securities backed by commercial real estate due to reduced price transparency.

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(1) The CMBX and ABX are indices that track the performance of commercial mortgage bonds and subprime residential mortgage bonds, respectively.

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The following table sets forth the fair values of financial assets classified as level 3 within the fair value hierarchy:

### **Level 3 Financial Assets at Fair Value** (in millions)

Description	As of November	
	2008	2007
Private equity and real estate fund investments (1)	\$16,006	\$ 18,006
Bank loans and bridge loans (2)	11,957	13,334
Corporate debt securities and other debt obligations (3)	7,596	6,111
Mortgage and other asset-backed loans and securities		
Loans and securities backed by commercial real estate	9,340	7,410
Loans and securities backed by residential real estate	2,049	2,484
Loan portfolios (4)	4,118	6,106
Cash instruments	51,066	53,451
Derivative contracts	15,124	15,700
Total level 3 assets at fair value	66,190	69,151
Level 3 assets for which we do not bear economic exposure (5)	(6,616)	(14,437)
Level 3 assets for which we bear economic exposure	<u>\$59,574</u>	<u>\$ 54,714</u>

(1) Includes \$1.18 billion and \$7.06 billion as of November 2008 and November 2007, respectively, of assets for which we do not bear economic exposure. Also includes \$2.62 billion and \$2.02 billion as of November 2008 and November 2007, respectively, of real estate fund investments.

(2) Includes mezzanine financing, leveraged loans arising from capital market transactions and other corporate bank debt.

(3) Includes \$804 million and \$2.49 billion as of November 2008 and November 2007, respectively, of CDOs backed by corporate obligations.

(4) Consists of acquired portfolios of distressed loans, primarily backed by commercial and residential real estate collateral.

(5) We do not bear economic exposure to these level 3 assets as they are financed by nonrecourse debt, attributable to minority investors or attributable to employee interests in certain consolidated funds.

**Loans and securities backed by residential real estate.** We securitize, underwrite and make markets in various types of residential mortgages, including prime, Alt-A and subprime. At any point in time, we may use cash instruments as well as derivatives to manage our long or short risk position in residential real estate. The following table sets forth the fair value of our long positions in prime, Alt-A and subprime mortgage cash instruments:

**Long Positions in Loans and Securities Backed by Residential Real Estate**  
(in millions)

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
Prime (1)	\$1,494	\$ 7,135
Alt-A	1,845	6,358
Subprime (2)	<u>1,906</u>	<u>2,109</u>
Total (3)	<u>\$5,245</u>	<u>\$15,602</u>

(1) Excludes U.S. government agency-issued collateralized mortgage obligations of \$4.27 billion and \$7.24 billion as of November 2008 and November 2007, respectively. Also excludes U.S. government agency-issued mortgage-pass through certificates.

(2) Includes \$228 million and \$316 million of CDOs backed by subprime mortgages as of November 2008 and November 2007, respectively.

(3) Includes \$2.05 billion and \$2.48 billion of financial instruments (primarily loans and investment-grade securities, the majority of which were issued during 2006 and 2007) classified as level 3 under the fair value hierarchy as of November 2008 and November 2007, respectively.

**Loans and securities backed by commercial real estate.** We originate, securitize and syndicate fixed and floating rate commercial mortgages globally. At any point in time, we may use cash instruments as well as derivatives to manage our risk position in the commercial mortgage market. The following table sets forth the fair value of our long positions in loans and securities backed by commercial real estate by geographic region. The decrease in loans and securities backed by commercial real estate from November 2007 to November 2008 was primarily due to dispositions.

**Long Positions in Loans and Securities Backed by  
Commercial Real Estate by Geographic Region**  
(in millions)

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
Americas (1)	\$ 7,433	\$12,361
EMEA (2)	3,304	6,607
Asia	<u>157</u>	<u>52</u>
Total (3)	<u>\$10,894 (4)</u>	<u>\$19,020 (5)</u>

(1) Substantially all relates to the U.S.

(2) EMEA (Europe, Middle East and Africa).

(3) Includes \$9.34 billion and \$7.41 billion of financial instruments classified as level 3 under the fair value hierarchy as of November 2008 and November 2007, respectively.

(4) Comprised of loans of \$9.23 billion and commercial mortgage-backed securities of \$1.66 billion as of November 2008, of which \$9.78 billion was floating rate and \$1.11 billion was fixed rate.

(5) Comprised of loans of \$16.27 billion and commercial mortgage-backed securities of \$2.75 billion as of November 2007, of which \$16.52 billion was floating rate and \$2.50 billion was fixed rate.



**Other Financial Assets and Financial Liabilities at Fair Value.** In addition to “Trading assets, at fair value” and “Trading liabilities, at fair value,” we have elected to account for certain of our other financial assets and financial liabilities at fair value under the fair value option. The primary reasons for electing the fair value option are to reflect economic events in earnings on a timely basis, to mitigate volatility in earnings from using different measurement attributes and to address simplification and cost-benefit considerations.

Such financial assets and financial liabilities accounted for at fair value include:

- certain unsecured short-term borrowings, consisting of all promissory notes and commercial paper and certain hybrid financial instruments;
- certain other secured financings, primarily transfers accounted for as financings rather than sales under SFAS No. 140, debt raised through our William Street program and certain other nonrecourse financings;
- certain unsecured long-term borrowings, including prepaid physical commodity transactions;
- resale and repurchase agreements;
- securities borrowed and loaned within Trading and Principal Investments, consisting of our matched book and certain firm financing activities;
- certain corporate loans, loan commitments and certificates of deposit issued by GS Bank USA as well as securities held by GS Bank USA;
- receivables from customers and counterparties arising from transfers accounted for as secured loans rather than purchases under SFAS No. 140;
- certain insurance and reinsurance contracts; and
- in general, investments acquired after the adoption of SFAS No. 159 where we have significant influence over the investee and would otherwise apply the equity method of accounting. In certain cases, we may apply the equity method of accounting to new investments that are strategic in nature or closely related to our principal business activities, where we have a significant degree of involvement in the cash flows or operations of the investee, or where cost-benefit considerations are less significant.

### **Goodwill and Identifiable Intangible Assets**

As a result of our acquisitions, principally SLK LLC (SLK) in 2000, The Ayco Company, L.P. (Ayco) in 2003 and our variable annuity and life insurance business in 2006, we have acquired goodwill and identifiable intangible assets. Goodwill is the cost of acquired companies in excess of the fair value of net assets, including identifiable intangible assets, at the acquisition date.

**Goodwill.** We test the goodwill in each of our operating segments, which are components one level below our three business segments, for impairment at least annually in accordance with SFAS No. 142, “Goodwill and Other Intangible Assets,” by comparing the estimated fair value of each operating segment with its estimated net book value. We derive the fair value of each of our operating segments based on valuation techniques we believe market participants would use for each segment (observable average price-to-earnings multiples of our competitors in these businesses and price-to-book multiples). We derive the net book value of our operating segments by estimating the amount of shareholders’ equity required to support the activities of each operating segment. Our last annual impairment test was performed during our 2008 fourth quarter and no impairment was identified. Substantially all of our goodwill is in our Equities component of our Trading and Principal Investments segment and in our Asset Management and Securities Services segment. Our Asset Management and Securities Services segment generated record net revenues in 2008 and our Equities component of our Trading and Principal Investments segment had its second best year following its record net revenues in 2007.



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During 2008, particularly during the fourth quarter, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity. Our stock price, consistent with stock prices in the broader financial services sector, declined significantly during this period of time. During the fourth quarter of 2008, our market capitalization fell below recorded book value, principally during the last five weeks of the quarter. With respect to the testing of our goodwill for impairment, we believe that it is reasonable to consider market capitalization as an indicator of fair value over a reasonable period of time. If the current economic market conditions persist and if there is a prolonged period of weakness in the business environment and financial markets, our businesses may be adversely affected, which could result in an impairment of goodwill in the future.

The following table sets forth the carrying value of our goodwill by operating segment:

### **Goodwill by Operating Segment** (in millions)

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
Investment Banking		
Underwriting	\$ 125	\$ 125
Trading and Principal Investments		
FICC	247	123
Equities (1)	2,389	2,381
Principal Investments	80	11
Asset Management and Securities Services		
Asset Management (2)	565	564
Securities Services	117	117
Total	<u>\$3,523</u>	<u>\$3,321</u>

(1) Primarily related to SLK.

(2) Primarily related to Ayco.

**Identifiable Intangible Assets.** We amortize our identifiable intangible assets over their estimated lives in accordance with SFAS No. 142 or, in the case of insurance contracts, in accordance with SFAS No. 60, "Accounting and Reporting by Insurance Enterprises," and SFAS No. 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments." Identifiable intangible assets are tested for impairment whenever events or changes in circumstances suggest that an asset's or asset group's carrying value may not be fully recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," or SFAS No. 60 and SFAS No. 97. An impairment loss, generally calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the sum of the estimated undiscounted cash flows relating to the asset or asset group is less than the corresponding carrying value.

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The following table sets forth the carrying value and range of remaining lives of our identifiable intangible assets by major asset class:

### **Identifiable Intangible Assets by Asset Class** (\$ in millions)

	As of November		
	2008	2007	
	Carrying Value	Range of Estimated Remaining Lives (in years)	Carrying Value
Customer lists (1)	\$ 724	2 - 17	\$ 732
New York Stock Exchange (NYSE) Designated Market Maker (DMM) rights	462	13	502
Insurance-related assets (2)	303	7	372
Exchange-traded fund (ETF) lead market maker rights	95	19	100
Other (3)	93	1 - 17	65
Total	\$1,677		\$1,771

(1) Primarily includes our clearance and execution and NASDAQ customer lists related to SLK and financial counseling customer lists related to Ayco.

(2) Consists of the value of business acquired (VOBA) and deferred acquisition costs (DAC). VOBA represents the present value of estimated future gross profits of acquired variable annuity and life insurance businesses. DAC results from commissions paid by Goldman Sachs to the primary insurer (ceding company) on life and annuity reinsurance agreements as compensation to place the business with us and to cover the ceding company's acquisition expenses. VOBA and DAC are amortized over the estimated life of the underlying contracts based on estimated gross profits, and amortization is adjusted based on actual experience. The seven-year estimated life represents the weighted average remaining amortization period of the underlying contracts (certain of which extend for approximately 30 years).

(3) Primarily includes marketing-related assets and power contracts.

A prolonged period of weakness in global equity markets and the trading of securities in multiple markets and on multiple exchanges could adversely impact our businesses and impair the value of our identifiable intangible assets. In addition, certain events could indicate a potential impairment of our identifiable intangible assets, including (i) changes in market structure that could adversely affect our specialist businesses (see discussion below), (ii) an adverse action or assessment by a regulator, or (iii) adverse actual experience on the contracts in our variable annuity and life insurance business.

In October 2008, the SEC approved the NYSE's proposal to create a new market model and redefine the role of NYSE DMMs. This new rule set further aligns the NYSE's model with investor requirements for speed and efficiency of execution and establishes specialists as DMMs. While DMMs still have an obligation to commit capital, they are now able to trade on parity with other market participants. In addition, in November 2008 the NYSE introduced a reserve order type that allows for anonymous trade execution, which is expected to allow the NYSE to recapture liquidity and market share from other venues in which anonymous reserve orders have been available for some time. The new rule set and the launch of the reserve order type, in combination with technology improvements to increase execution speed, are expected to bolster the NYSE's competitive position.

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In 2007, we tested our NYSE DMM rights for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Under SFAS No. 144, an impairment loss is recognized if the carrying amount of our NYSE DMM rights exceeds the projected undiscounted cash flows of the business over the estimated remaining life of our NYSE DMM rights. Projected undiscounted cash flows exceeded the carrying amount of our NYSE DMM rights, and accordingly we did not record an impairment loss. In projecting the undiscounted cash flows of the business, we made several important assumptions about the potential beneficial effects of the rule and market structure changes described above. Specifically, we assumed that:

- total equity trading volumes in NYSE-listed companies will continue to grow at a rate consistent with recent historical trends;
- the NYSE will be able to recapture approximately one-half of the market share that it lost in 2007; and
- we will increase our market share of the NYSE DMM business and, as a DMM, the profitability of each share traded.

We also assumed that the rule changes would be implemented in our fiscal fourth quarter of 2008 (as noted above, such rule changes were approved in October 2008) and that projected cash flow increases related to the implementation of the rule set would begin in 2009, consistent with the assumptions above. Subsequently, there have been no events or changes in circumstances indicating that NYSE DMM rights intangible asset may not be recoverable. However, there can be no assurance that the assumptions, rule or structure changes described above will result in sufficient cash flows to avoid impairment of our NYSE DMM rights in the future. We will continue to evaluate the performance of the specialist business under the new market model. As of November 2008, the carrying value of our NYSE DMM rights was \$462 million. To the extent that there were to be an impairment in the future, it could result in a significant writedown in the carrying value of these DMM rights.

### **Use of Estimates**

The use of generally accepted accounting principles requires management to make certain estimates and assumptions. In addition to the estimates we make in connection with fair value measurements and the accounting for goodwill and identifiable intangible assets, the use of estimates and assumptions is also important in determining provisions for potential losses that may arise from litigation and regulatory proceedings and tax audits.

We estimate and provide for potential losses that may arise out of litigation and regulatory proceedings to the extent that such losses are probable and can be estimated, in accordance with SFAS No. 5, "Accounting for Contingencies." We estimate and provide for potential liabilities that may arise out of tax audits to the extent that uncertain tax positions fail to meet the recognition standard of FIN 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109." See Note 16 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information on FIN 48.

Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total estimated liability in respect of litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses after considering, among other factors, the progress of each case or proceeding, our experience and the experience of others in similar cases or proceedings, and the opinions and views of legal counsel. Given the inherent difficulty of predicting the outcome of our litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, we cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred. See "— Legal Proceedings" in Part I, Item 3 of our Annual Report on Form 10-K for information on our judicial, regulatory and arbitration proceedings.

## Results of Operations

The composition of our net revenues has varied over time as financial markets and the scope of our operations have changed. The composition of net revenues can also vary over the shorter term due to fluctuations in U.S. and global economic and market conditions. See “— Certain Risk Factors That May Affect Our Businesses” above and “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for a further discussion of the impact of economic and market conditions on our results of operations.

## Financial Overview

The following table sets forth an overview of our financial results:

### Financial Overview (\$ in millions, except per share amounts)

	Year Ended November		
	2008	2007	2006
Net revenues	\$22,222	\$45,987	\$37,665
Pre-tax earnings	2,336	17,604	14,560
Net earnings	2,322	11,599	9,537
Net earnings applicable to common shareholders	2,041	11,407	9,398
Diluted earnings per common share	4.47	24.73	19.69
Return on average common shareholders' equity (1)	4.9%	32.7%	32.8%
Return on average tangible common shareholders' equity (2)	5.5%	38.2%	39.8%

(1) Return on average common shareholders' equity (ROE) is computed by dividing net earnings applicable to common shareholders by average monthly common shareholders' equity.

(2) Tangible common shareholders' equity equals total shareholders' equity less preferred stock, goodwill and identifiable intangible assets, excluding power contracts. Identifiable intangible assets associated with power contracts are not deducted from total shareholders' equity because, unlike other intangible assets, less than 50% of these assets are supported by common shareholders' equity.

We believe that return on average tangible common shareholders' equity (ROTE) is meaningful because it measures the performance of businesses consistently, whether they were acquired or developed internally. ROTE is computed by dividing net earnings applicable to common shareholders by average monthly tangible common shareholders' equity.

The following table sets forth the reconciliation of average total shareholders' equity to average tangible common shareholders' equity:

	Average for the Year Ended November		
	2008	2007	2006
	(in millions)		
Total shareholders' equity	\$47,167	\$37,959	\$31,048
Preferred stock	(5,157)	(3,100)	(2,400)
Common shareholders' equity	42,010	34,859	28,648
Goodwill and identifiable intangible assets, excluding power contracts	(5,220)	(4,971)	(5,013)
Tangible common shareholders' equity	<u>\$36,790</u>	<u>\$29,888</u>	<u>\$23,635</u>

## **Net Revenues**

**2008 versus 2007.** Our net revenues were \$22.22 billion in 2008, a decrease of 52% compared with 2007, reflecting a particularly difficult operating environment, including significant asset price declines, high levels of volatility and reduced levels of liquidity, particularly in the fourth quarter. In addition, credit markets experienced significant dislocation between prices for cash instruments and the related derivative contracts and between credit indices and underlying single names. Net revenues in Trading and Principal Investments were significantly lower compared with 2007, reflecting significant declines in FICC, Principal Investments and Equities. The decrease in FICC primarily reflected losses in credit products, which included a loss of approximately \$3.1 billion (net of hedges) related to non-investment-grade credit origination activities and losses from investments, including corporate debt and private and public equities. Results in mortgages included net losses of approximately \$1.7 billion on residential mortgage loans and securities and approximately \$1.4 billion on commercial mortgage loans and securities. Interest rate products, currencies and commodities each produced particularly strong results and net revenues were higher compared with 2007. During 2008, although client-driven activity was generally solid, FICC operated in a challenging environment characterized by broad-based declines in asset values, wider mortgage and corporate credit spreads, reduced levels of liquidity and broad-based investor deleveraging, particularly in the second half of the year. The decline in Principal Investments primarily reflected net losses of \$2.53 billion from corporate principal investments and \$949 million from real estate principal investments, as well as a \$446 million loss from our investment in the ordinary shares of ICBC. In Equities, the decrease compared with particularly strong net revenues in 2007 reflected losses in principal strategies, partially offset by higher net revenues in our client franchise businesses. Commissions were particularly strong and were higher than 2007. During 2008, Equities operated in an environment characterized by a significant decline in global equity prices, broad-based investor deleveraging and very high levels of volatility, particularly in the second half of the year.

Net revenues in Investment Banking also declined significantly compared with 2007, reflecting significantly lower net revenues in both Financial Advisory and Underwriting. In Financial Advisory, the decrease compared with particularly strong net revenues in 2007 reflected a decline in industry-wide completed mergers and acquisitions. The decrease in Underwriting primarily reflected significantly lower net revenues in debt underwriting, primarily due to a decline in leveraged finance and mortgage-related activity, reflecting difficult market conditions. Net revenues in equity underwriting were slightly lower compared with 2007, reflecting a decrease in industry-wide equity and equity-related offerings.

Net revenues in Asset Management and Securities Services increased compared with 2007. Securities Services net revenues were higher, reflecting the impact of changes in the composition of securities lending customer balances, as well as higher total average customer balances. Asset Management net revenues increased slightly compared with 2007. During the year, assets under management decreased \$89 billion to \$779 billion, due to \$123 billion of market depreciation, primarily in equity assets, partially offset by \$34 billion of net inflows.

**2007 versus 2006.** Our net revenues were \$45.99 billion in 2007, an increase of 22% compared with 2006, reflecting significantly higher net revenues in Trading and Principal Investments and Investment Banking, and higher net revenues in Asset Management and Securities Services. The increase in Trading and Principal Investments reflected higher net revenues in Equities, FICC and Principal Investments. Net revenues in Equities increased 33% compared with 2006, reflecting significantly higher net revenues in both our client franchise businesses and principal strategies. During 2007, Equities operated in an environment characterized by strong client-driven activity, generally higher equity prices and higher levels of volatility, particularly during the second half of the year. The increase in FICC reflected significantly higher net revenues in currencies and interest rate products. In addition, net revenues in mortgages were higher despite a significant deterioration in the mortgage market throughout the year, while net revenues in credit products were strong, but slightly lower compared with 2006. Credit products included substantial gains from equity investments, including a gain of approximately \$900 million related to the disposition of Horizon Wind Energy L.L.C., as well as a loss of approximately \$1 billion (net of hedges) related to non-investment-grade credit origination activities. During 2007, FICC operated in an environment generally characterized by strong client-driven activity and favorable market opportunities. However, during the year, the mortgage market experienced significant deterioration and, in the second half of the year, the broader credit markets were characterized by wider spreads and reduced levels of liquidity. The increase in Principal Investments reflected strong results in both corporate and real estate investing.

The increase in Investment Banking reflected a 64% increase in Financial Advisory net revenues and a strong performance in our Underwriting business. The increase in Financial Advisory primarily reflected growth in industry-wide completed mergers and acquisitions. The increase in Underwriting reflected higher net revenues in debt underwriting, as leveraged finance activity was strong during the first half of our fiscal year, while net revenues in equity underwriting were strong but essentially unchanged from 2006.

Net revenues in Asset Management and Securities Services also increased. The increase in Securities Services primarily reflected significant growth in global customer balances. The increase in Asset Management reflected significantly higher asset management fees, partially offset by significantly lower incentive fees. During the year, assets under management increased \$192 billion, or 28%, to \$868 billion, including net inflows of \$161 billion.

## Operating Expenses

Our operating expenses are primarily influenced by compensation, headcount and levels of business activity. A substantial portion of our compensation expense represents discretionary bonuses which are significantly impacted by, among other factors, the level of net revenues, prevailing labor markets, business mix and the structure of our share-based compensation programs. For 2008, our ratio of compensation and benefits (excluding severance costs of approximately \$275 million in the fourth quarter of 2008) to net revenues was 48.0%. Our ratio of compensation and benefits to net revenues was 43.9% for 2007.

The following table sets forth our operating expenses and number of employees:

### Operating Expenses and Employees (\$ in millions)

	Year Ended November		
	2008	2007	2006
Compensation and benefits (1)	\$10,934	\$20,190	\$16,457
Brokerage, clearing, exchange and distribution fees	2,998	2,758	1,985
Market development	485	601	492
Communications and technology	759	665	544
Depreciation and amortization	1,022	624	521
Amortization of identifiable intangible assets	240	195	173
Occupancy	960	975	850
Professional fees	779	714	545
Other expenses (2)	1,709	1,661	1,538
Total non-compensation expenses	8,952	8,193	6,648
Total operating expenses	<u>\$19,886</u>	<u>\$28,383</u>	<u>\$23,105</u>
Employees at year-end (3)	30,067	30,522	26,467

(1) Compensation and benefits includes \$262 million, \$168 million and \$259 million for the years ended November 2008, November 2007 and November 2006, respectively, attributable to consolidated entities held for investment purposes. Consolidated entities held for investment purposes are entities that are held strictly for capital appreciation, have a defined exit strategy and are engaged in activities that are not closely related to our principal businesses.

(2) Beginning in the first quarter of 2008, "Cost of power generation" was reclassified into "Other expenses" in the consolidated statements of earnings. Prior periods have been reclassified to conform to the current presentation.

(3) Excludes 4,671, 4,572 and 3,868 employees as of November 2008, November 2007 and November 2006, respectively, of consolidated entities held for investment purposes (see footnote 1 above).



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The following table sets forth non-compensation expenses of consolidated entities held for investment purposes and our remaining non-compensation expenses by line item:

### **Non-Compensation Expenses** (in millions)

	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Non-compensation expenses of consolidated investments (1)	\$ 779	\$ 446	\$ 501
Non-compensation expenses excluding consolidated investments			
Brokerage, clearing, exchange and distribution fees	2,998	2,758	1,985
Market development	475	593	461
Communications and technology	754	661	537
Depreciation and amortization	631	509	444
Amortization of identifiable intangible assets	233	189	169
Occupancy	861	892	738
Professional fees	770	711	534
Other expenses (2)	<u>1,451</u>	<u>1,434</u>	<u>1,279</u>
Subtotal	<u>8,173</u>	<u>7,747</u>	<u>6,147</u>
Total non-compensation expenses, as reported	<u>\$8,952</u>	<u>\$8,193</u>	<u>\$6,648</u>

(1) Consolidated entities held for investment purposes are entities that are held strictly for capital appreciation, have a defined exit strategy and are engaged in activities that are not closely related to our principal businesses. For example, these investments include consolidated entities that hold real estate assets, such as hotels, but exclude investments in entities that primarily hold financial assets. We believe that it is meaningful to review non-compensation expenses excluding expenses related to these consolidated entities in order to evaluate trends in non-compensation expenses related to our principal business activities. Revenues related to such entities are included in "Trading and principal investments" in the consolidated statements of earnings.

(2) Beginning in the first quarter of 2008, "Cost of power generation" was reclassified into "Other expenses" in the consolidated statements of earnings. Prior periods have been reclassified to conform to the current presentation.

**2008 versus 2007.** Operating expenses were \$19.89 billion for 2008, 30% lower than 2007. Compensation and benefits expenses (including salaries, bonuses, amortization of prior year equity awards and other items such as payroll taxes and benefits) of \$10.93 billion decreased 46% compared with 2007, reflecting lower levels of discretionary compensation due to lower net revenues. For 2008, our ratio of compensation and benefits (excluding severance costs of approximately \$275 million in the fourth quarter of 2008) to net revenues was 48.0%. Our ratio of compensation and benefits to net revenues was 43.9% for 2007. Employment levels decreased 1% compared with November 2007, reflecting an 8% decrease during the fourth quarter.

Non-compensation expenses of \$8.95 billion for 2008 increased 9% compared with 2007. Excluding consolidated entities held for investment purposes, non-compensation expenses increased 5% compared with 2007. The majority of this increase was attributable to higher brokerage, clearing, exchange and distribution fees, principally reflecting higher activity levels in Equities and FICC. The increase in non-compensation expenses related to consolidated entities held for investment purposes primarily reflected the impact of impairment on certain real estate assets during 2008.

**2007 versus 2006.** Operating expenses were \$28.38 billion for 2007, 23% higher than 2006. Compensation and benefits expenses of \$20.19 billion increased 23% compared with 2006, reflecting increased discretionary compensation and growth in employment levels. The ratio of compensation and benefits to net revenues for 2007 was 43.9% compared with 43.7% for 2006. Employment levels increased 15% compared with November 2006.

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Non-compensation expenses of \$8.19 billion for 2007 increased 23% compared with 2006, primarily attributable to higher levels of business activity and continued geographic expansion. One-half of this increase was attributable to brokerage, clearing, exchange and distribution fees, principally reflecting higher transaction volumes in Equities. Professional fees, other expenses and communications and technology expenses also increased, primarily due to higher levels of business activity. Occupancy and depreciation and amortization expenses in 2007 included exit costs of \$128 million related to our office space.

### ***Provision for Taxes***

The effective income tax rate was approximately 1% for 2008, down from 34.1% for 2007. The decrease in the effective income tax rate was primarily due to an increase in permanent benefits as a percentage of lower earnings and changes in geographic earnings mix. The effective income tax rate was 34.1% for 2007, down from 34.5% for 2006, primarily due to changes in the geographic mix of earnings.

Our effective income tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings, the level of our pre-tax earnings, the level of our tax credits and the effect of tax audits. Certain of these and other factors, including our history of pre-tax earnings, are taken into account in assessing our ability to realize our net deferred tax assets. See Note 16 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our provision for taxes.

## Segment Operating Results

The following table sets forth the net revenues, operating expenses and pre-tax earnings of our segments:

		<b>Segment Operating Results</b> (in millions)		
		Year Ended November		
		<u>2008</u>	<u>2007</u>	<u>2006</u>
<b>Investment Banking</b>	Net revenues	\$ 5,185	\$ 7,555	\$ 5,629
	Operating expenses	<u>3,143</u>	<u>4,985</u>	<u>4,062</u>
	Pre-tax earnings	<u>\$ 2,042</u>	<u>\$ 2,570</u>	<u>\$ 1,567</u>
<b>Trading and Principal Investments</b>	Net revenues	\$ 9,063	\$31,226	\$25,562
	Operating expenses	<u>11,808</u>	<u>17,998</u>	<u>14,962</u>
	Pre-tax earnings/(loss)	<u>\$ (2,745)</u>	<u>\$13,228</u>	<u>\$10,600</u>
<b>Asset Management and Securities Services</b>	Net revenues	\$ 7,974	\$ 7,206	\$ 6,474
	Operating expenses	<u>4,939</u>	<u>5,363</u>	<u>4,036</u>
	Pre-tax earnings	<u>\$ 3,035</u>	<u>\$ 1,843</u>	<u>\$ 2,438</u>
<b>Total</b>	Net revenues	\$22,222	\$45,987	\$37,665
	Operating expenses (1)	<u>19,886</u>	<u>28,383</u>	<u>23,105</u>
	Pre-tax earnings	<u>\$ 2,336</u>	<u>\$17,604</u>	<u>\$14,560</u>

(1) Operating expenses include net provisions for a number of litigation and regulatory proceedings of \$(4) million, \$37 million and \$45 million for the years ended November 2008, November 2007 and November 2006, respectively, that have not been allocated to our segments.

Net revenues in our segments include allocations of interest income and interest expense to specific securities, commodities and other positions in relation to the cash generated by, or funding requirements of, such underlying positions. See Note 18 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our business segments.

The cost drivers of Goldman Sachs taken as a whole — compensation, headcount and levels of business activity — are broadly similar in each of our business segments. Compensation and benefits expenses within our segments reflect, among other factors, the overall performance of Goldman Sachs as well as the performance of individual business units. Consequently, pre-tax margins in one segment of our business may be significantly affected by the performance of our other business segments. A discussion of segment operating results follows.

## **Investment Banking**

Our Investment Banking segment is divided into two components:

- **Financial Advisory.** Financial Advisory includes advisory assignments with respect to mergers and acquisitions, divestitures, corporate defense activities, restructurings and spin-offs.
- **Underwriting.** Underwriting includes public offerings and private placements of a wide range of securities and other financial instruments.

The following table sets forth the operating results of our Investment Banking segment:

### **Investment Banking Operating Results** (in millions)

	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Financial Advisory	\$2,656	\$4,222	\$2,580
Equity underwriting	1,353	1,382	1,365
Debt underwriting	1,176	1,951	1,684
Total Underwriting	2,529	3,333	3,049
Total net revenues	5,185	7,555	5,629
Operating expenses	3,143	4,985	4,062
Pre-tax earnings	\$2,042	\$2,570	\$1,567

The following table sets forth our financial advisory and underwriting transaction volumes:

### **Goldman Sachs Global Investment Banking Volumes (1)** (in billions)

	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Announced mergers and acquisitions	\$927	\$1,249	\$1,101
Completed mergers and acquisitions	823	1,443	863
Equity and equity-related offerings (2)	61	66	74
Debt offerings (3)	185	345	320

(1) Source: Thomson Reuters. Announced and completed mergers and acquisitions volumes are based on full credit to each of the advisors in a transaction. Equity and equity-related offerings and debt offerings are based on full credit for single book managers and equal credit for joint book managers. Transaction volumes may not be indicative of net revenues in a given period. In addition, transaction volumes for prior periods may vary from amounts previously reported due to the subsequent withdrawal or a change in the value of a previously announced transaction.

(2) Includes Rule 144A and public common stock offerings, convertible offerings and rights offerings.

(3) Includes non-convertible preferred stock, mortgage-backed securities, asset-backed securities and taxable municipal debt. Includes publicly registered and Rule 144A issues.

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**2008 versus 2007.** Net revenues in Investment Banking of \$5.19 billion for 2008 decreased 31% compared with 2007.

Net revenues in Financial Advisory of \$2.66 billion decreased 37% compared with particularly strong net revenues in 2007, primarily reflecting a decline in industry-wide completed mergers and acquisitions. Net revenues in our Underwriting business of \$2.53 billion decreased 24% compared with 2007, principally due to significantly lower net revenues in debt underwriting. The decrease in debt underwriting was primarily due to a decline in leveraged finance and mortgage-related activity, reflecting difficult market conditions. Net revenues in equity underwriting were slightly lower compared with 2007, reflecting a decrease in industry-wide equity and equity-related offerings. Our investment banking transaction backlog ended the year significantly lower than at the end of 2007. <sup>(1)</sup>

Operating expenses of \$3.14 billion for 2008 decreased 37% compared with 2007, due to decreased compensation and benefits expenses, resulting from lower levels of discretionary compensation. Pre-tax earnings of \$2.04 billion in 2008 decreased 21% compared with 2007.

**2007 versus 2006.** Net revenues in Investment Banking of \$7.56 billion for 2007 increased 34% compared with 2006.

Net revenues in Financial Advisory of \$4.22 billion increased 64% compared with 2006, primarily reflecting growth in industry-wide completed mergers and acquisitions. Net revenues in our Underwriting business of \$3.33 billion increased 9% compared with 2006, due to higher net revenues in debt underwriting, primarily reflecting strength in leveraged finance during the first half of 2007. Net revenues in equity underwriting were also strong, but essentially unchanged from 2006. Our investment banking transaction backlog at the end of 2007 was higher than at the end of 2006. <sup>(1)</sup>

Operating expenses of \$4.99 billion for 2007 increased 23% compared with 2006, primarily due to increased compensation and benefits expenses, resulting from higher discretionary compensation and growth in employment levels. Pre-tax earnings of \$2.57 billion in 2007 increased 64% compared with 2006.

### ***Trading and Principal Investments***

Our Trading and Principal Investments segment is divided into three components:

- **FICC.** We make markets in and trade interest rate and credit products, mortgage-related securities and loan products and other asset-backed instruments, currencies and commodities, structure and enter into a wide variety of derivative transactions, and engage in proprietary trading and investing.
- **Equities.** We make markets in and trade equities and equity-related products, structure and enter into equity derivative transactions and engage in proprietary trading. We generate commissions from executing and clearing client transactions on major stock, options and futures exchanges worldwide through our Equities client franchise and clearing activities. We also engage in specialist and insurance activities.
- **Principal Investments.** We make real estate and corporate principal investments, including our investment in the ordinary shares of ICBC. We generate net revenues from returns on these investments and from the increased share of the income and gains derived from our merchant banking funds when the return on a fund's investments over the life of the fund exceeds certain threshold returns (typically referred to as an override).

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<sup>(1)</sup> Our investment banking transaction backlog represents an estimate of our future net revenues from investment banking transactions where we believe that future revenue realization is more likely than not.

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Substantially all of our inventory is marked-to-market daily and, therefore, its value and our net revenues are subject to fluctuations based on market movements. In addition, net revenues derived from our principal investments, including those in privately held concerns and in real estate, may fluctuate significantly depending on the revaluation of these investments in any given period. We also regularly enter into large transactions as part of our trading businesses. The number and size of such transactions may affect our results of operations in a given period.

Net revenues from Principal Investments do not include management fees generated from our merchant banking funds. These management fees are included in the net revenues of the Asset Management and Securities Services segment.

The following table sets forth the operating results of our Trading and Principal Investments segment:

### **Trading and Principal Investments Operating Results** (in millions)

	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
FICC	\$ 3,713	\$16,165	\$14,262
Equities trading	4,208	6,725	4,965
Equities commissions	4,998	4,579	3,518
Total Equities	9,206	11,304	8,483
ICBC	(446)	495	937
Gross gains	1,335	3,728	2,061
Gross losses	(4,815)	(943)	(585)
Net other corporate and real estate investments	(3,480)	2,785	1,476
Overrides	70	477	404
Total Principal Investments	(3,856)	3,757	2,817
Total net revenues	9,063	31,226	25,562
Operating expenses	11,808	17,998	14,962
Pre-tax earnings/(loss)	<u>\$ (2,745)</u>	<u>\$13,228</u>	<u>\$10,600</u>

**2008 versus 2007.** Net revenues in Trading and Principal Investments of \$9.06 billion for 2008 decreased 71% compared with 2007.

Net revenues in FICC of \$3.71 billion for 2008 decreased 77% compared with 2007, primarily reflecting losses in credit products, which included a loss of approximately \$3.1 billion (net of hedges) related to non-investment-grade credit origination activities and losses from investments, including corporate debt and private and public equities. Results in mortgages included net losses of approximately \$1.7 billion on residential mortgage loans and securities and approximately \$1.4 billion on commercial mortgage loans and securities. Interest rate products, currencies and commodities each produced particularly strong results and net revenues were higher compared with 2007. During 2008, although client-driven activity was generally solid, FICC operated in a challenging environment characterized by broad-based declines in asset values, wider mortgage and corporate credit spreads, reduced levels of liquidity and broad-based investor deleveraging, particularly in the second half of the year.

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Net revenues in Equities of \$9.21 billion for 2008 decreased 19% compared with a particularly strong 2007, reflecting losses in principal strategies, partially offset by higher net revenues in the client franchise businesses. Commissions were particularly strong and were higher than 2007. During 2008, Equities operated in an environment characterized by a significant decline in global equity prices, broad-based investor deleveraging and very high levels of volatility, particularly in the second half of the year.

Principal Investments recorded a net loss of \$3.86 billion for 2008. These results included net losses of \$2.53 billion from corporate principal investments and \$949 million from real estate principal investments, as well as a \$446 million loss related to our investment in the ordinary shares of ICBC.

Operating expenses of \$11.81 billion for 2008 decreased 34% compared with 2007, due to decreased compensation and benefits expenses, resulting from lower levels of discretionary compensation. This decrease was partially offset by higher non-compensation expenses. Excluding consolidated entities held for investment purposes, the majority of this increase was attributable to higher brokerage, clearing, exchange and distribution fees, principally reflecting higher activity levels in Equities and FICC. The increase in non-compensation expenses related to consolidated entities held for investment purposes primarily reflected the impact of impairment on certain real estate assets during 2008. Pre-tax loss was \$2.75 billion in 2008 compared with pre-tax earnings of \$13.23 billion in 2007.

**2007 versus 2006.** Net revenues in Trading and Principal Investments of \$31.23 billion for 2007 increased 22% compared with 2006.

Net revenues in FICC of \$16.17 billion for 2007 increased 13% compared with 2006, reflecting significantly higher net revenues in currencies and interest rate products. In addition, net revenues in mortgages were higher despite a significant deterioration in the mortgage market throughout 2007, while net revenues in credit products were strong, but slightly lower compared with 2006. Credit products included substantial gains from equity investments, including a gain of approximately \$900 million related to the disposition of Horizon Wind Energy L.L.C., as well as a loss of approximately \$1 billion (net of hedges) related to non-investment-grade credit origination activities. Net revenues in commodities were also strong but lower compared with 2006. During 2007, FICC operated in an environment generally characterized by strong client-driven activity and favorable market opportunities. However, during 2007, the mortgage market experienced significant deterioration and, in the second half of the year, the broader credit markets were characterized by wider spreads and reduced levels of liquidity.

Net revenues in Equities of \$11.30 billion for 2007 increased 33% compared with 2006, reflecting significantly higher net revenues in both our client franchise businesses and principal strategies. The client franchise businesses benefited from significantly higher commission volumes. During 2007, Equities operated in an environment characterized by strong client-driven activity, generally higher equity prices and higher levels of volatility, particularly during the second half of the year.

Principal Investments recorded net revenues of \$3.76 billion for 2007, reflecting gains and overrides from corporate and real estate principal investments. Results in Principal Investments included a \$495 million gain related to our investment in the ordinary shares of ICBC and a \$129 million loss related to our investment in the convertible preferred stock of SMFG.

Operating expenses of \$18.00 billion for 2007 increased 20% compared with 2006, primarily due to increased compensation and benefits expenses, resulting from higher discretionary compensation and growth in employment levels. Non-compensation expenses increased due to the impact of higher levels of business activity and continued geographic expansion. The majority of this increase was in brokerage, clearing, exchange and distribution fees, which primarily reflected higher transaction volumes in Equities. Professional fees also increased, reflecting increased business activity. Pre-tax earnings of \$13.23 billion in 2007 increased 25% compared with 2006.



## **Asset Management and Securities Services**

Our Asset Management and Securities Services segment is divided into two components:

- **Asset Management.** Asset Management provides investment advisory and financial planning services and offers investment products (primarily through separately managed accounts and commingled vehicles, such as mutual funds and private investment funds) across all major asset classes to a diverse group of institutions and individuals worldwide and primarily generates revenues in the form of management and incentive fees.
- **Securities Services.** Securities Services provides prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide, and generates revenues primarily in the form of interest rate spreads or fees.

Assets under management typically generate fees as a percentage of asset value, which is affected by investment performance and by inflows and redemptions. The fees that we charge vary by asset class, as do our related expenses. In certain circumstances, we are also entitled to receive incentive fees based on a percentage of a fund's return or when the return on assets under management exceeds specified benchmark returns or other performance targets. Incentive fees are recognized when the performance period ends and they are no longer subject to adjustment. We have numerous incentive fee arrangements, many of which have annual performance periods that end on December 31. For that reason, incentive fees have been seasonally weighted to our first quarter.

The following table sets forth the operating results of our Asset Management and Securities Services segment:

### **Asset Management and Securities Services Operating Results** (in millions)

	Year Ended November		
	2008	2007	2006
Management and other fees	\$4,321	\$4,303	\$3,332
Incentive fees	231	187	962
Total Asset Management	4,552	4,490	4,294
Securities Services	3,422	2,716	2,180
Total net revenues	7,974	7,206	6,474
Operating expenses	4,939	5,363	4,036
Pre-tax earnings	<u>\$3,035</u>	<u>\$1,843</u>	<u>\$2,438</u>

Assets under management include our mutual funds, alternative investment funds and separately managed accounts for institutional and individual investors. Substantially all assets under management are valued as of calendar month-end. Assets under management do not include:

- assets in brokerage accounts that generate commissions, mark-ups and spreads based on transactional activity,
- our own investments in funds that we manage;
- or non-fee-paying assets, including interest-bearing deposits held through our depository institution subsidiaries.

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The following table sets forth our assets under management by asset class:

### **Assets Under Management by Asset Class** (in billions)

	<b>As of November 30</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Alternative investments (1)	\$ 146	\$ 151	\$ 145
Equity	112	255	215
Fixed income	248	256	198
Total non-money market assets	506	662	558
Money markets	273	206	118
Total assets under management	<u>\$ 779</u>	<u>\$ 868</u>	<u>\$ 676</u>

(1) Primarily includes hedge funds, private equity, real estate, currencies, commodities and asset allocation strategies.

The following table sets forth a summary of the changes in our assets under management:

### **Changes in Assets Under Management** (in billions)

	<b>Year Ended November 30</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Balance, beginning of year	\$ 868	\$ 676	\$ 532
Net inflows/(outflows)			
Alternative investments	8	9	32
Equity	(55)	26	16
Fixed income	14	38	29
Total non-money market net inflows/(outflows)	(33)	73 (1)	77
Money markets	67	88	17 (2)
Total net inflows/(outflows)	34	161	94 (3)
Net market appreciation/(depreciation)	(123)	31	50
Balance, end of year	<u>\$ 779</u>	<u>\$ 868</u>	<u>\$ 676</u>

(1) Includes \$7 billion in net asset inflows in connection with our acquisition of Macquarie — IMM Investment Management.

(2) Net of the transfer of \$8 billion of money market assets under management to interest-bearing deposits at GS Bank USA.

(3) Includes \$3 billion of net asset inflows in connection with the acquisition of our variable annuity and life insurance business.

**2008 versus 2007.** Net revenues in Asset Management and Securities Services of \$7.97 billion for 2008 increased 11% compared with 2007.

Asset Management net revenues of \$4.55 billion for 2008 increased 1% compared with 2007. During 2008, assets under management decreased \$89 billion to \$779 billion, due to \$123 billion of market depreciation, primarily in equity assets, partially offset by \$34 billion of net inflows. Net inflows reflected inflows in money market, fixed income and alternative investment assets, partially offset by outflows in equity assets.

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Securities Services net revenues of \$3.42 billion for 2008 increased 26% compared with 2007, reflecting the impact of changes in the composition of securities lending customer balances, as well as higher total average customer balances.

Operating expenses of \$4.94 billion for 2008 decreased 8% compared with 2007, due to decreased compensation and benefits expenses, resulting from lower levels of discretionary compensation. Pre-tax earnings of \$3.04 billion in 2008 increased 65% compared with 2007.

**2007 versus 2006.** Net revenues in Asset Management and Securities Services of \$7.21 billion for 2007 increased 11% compared with 2006.

Asset Management net revenues of \$4.49 billion for 2007 increased 5% compared with 2006, reflecting a 29% increase in management and other fees, partially offset by significantly lower incentive fees. Incentive fees were \$187 million for 2007 compared with \$962 million for 2006. During 2007, assets under management increased \$192 billion, or 28%, to \$868 billion, reflecting non-money market net inflows of \$73 billion <sup>(1)</sup>, primarily in fixed income and equity assets, money market net inflows of \$88 billion, and net market appreciation of \$31 billion, reflecting appreciation in fixed income and equity assets, partially offset by depreciation in alternative investment assets.

Securities Services net revenues of \$2.72 billion for 2007 increased 25% compared with 2006, as our prime brokerage business continued to generate strong results, primarily reflecting significantly higher customer balances in securities lending and margin lending.

Operating expenses of \$5.36 billion for 2007 increased 33% compared with 2006, primarily due to increased compensation and benefits expenses, resulting from higher discretionary compensation and growth in employment levels, and higher distribution fees (included in brokerage, clearing, exchange and distribution fees). Pre-tax earnings of \$1.84 billion in 2007 decreased 24% compared with 2006.

### **Geographic Data**

See Note 18 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for a summary of our total net revenues, pre-tax earnings and net earnings by geographic region.

### **Off-Balance-Sheet Arrangements**

We have various types of off-balance-sheet arrangements that we enter into in the ordinary course of business. Our involvement in these arrangements can take many different forms, including purchasing or retaining residual and other interests in mortgage-backed and other asset-backed securitization vehicles; holding senior and subordinated debt, interests in limited and general partnerships, and preferred and common stock in other nonconsolidated vehicles; entering into interest rate, foreign currency, equity, commodity and credit derivatives, including total return swaps; entering into operating leases; and providing guarantees, indemnifications, loan commitments, letters of credit and representations and warranties.

We enter into these arrangements for a variety of business purposes, including the securitization of commercial and residential mortgages, home equity and auto loans, government and corporate bonds, and other types of financial assets. Other reasons for entering into these arrangements include underwriting client securitization transactions; providing secondary market liquidity; making investments in performing and nonperforming debt, equity, real estate and other assets; providing investors with credit-linked and asset-repackaged notes; and receiving or providing letters of credit to satisfy margin requirements and to facilitate the clearance and settlement process.

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<sup>(1)</sup> Includes \$7 billion in net asset inflows in connection with our acquisition of Macquarie — IMM Investment Management.

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We engage in transactions with variable interest entities (VIEs) and qualifying special-purpose entities (QSPEs). Such vehicles are critical to the functioning of several significant investor markets, including the mortgage-backed and other asset-backed securities markets, since they offer investors access to specific cash flows and risks created through the securitization process. Our financial interests in, and derivative transactions with, such nonconsolidated entities are accounted for at fair value, in the same manner as our other financial instruments, except in cases where we apply the equity method of accounting.

We did not have off-balance-sheet commitments to purchase or finance any CDOs held by structured investment vehicles as of November 2008 or November 2007.

In December 2007, the American Securitization Forum (ASF) issued the “Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans” (ASF Framework). The ASF Framework provides guidance for servicers to streamline borrower evaluation procedures and to facilitate the use of foreclosure and loss prevention measures for securitized subprime residential mortgages that meet certain criteria. For certain eligible loans as defined in the ASF Framework, servicers may presume default is reasonably foreseeable and apply a fast-track loan modification plan, under which the loan interest rate will be kept at the introductory rate for a period of five years following the upcoming reset date. Mortgage loan modifications of these eligible loans will not affect our accounting treatment for QSPEs that hold the subprime loans.

The following table sets forth where a discussion of off-balance-sheet arrangements may be found in Part II, Items 7 and 8 of our Annual Report on Form 10-K:

Type of Off-Balance-Sheet Arrangement	Disclosure in our Annual Report on Form 10-K
Retained interests or contingent interests in assets transferred by us to nonconsolidated entities	See Note 4 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K.
Leases, letters of credit, and loans and other commitments	See “— Contractual Obligations and Commitments” below and Note 8 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K.
Guarantees	See Note 8 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K.
Other obligations, including contingent obligations, arising out of variable interests we have in nonconsolidated entities	See Note 4 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K.
Derivative contracts	See “— Critical Accounting Policies” above, and “— Risk Management” and “— Derivatives” below and Notes 3 and 7 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K.

In addition, see Note 2 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for a discussion of our consolidation policies.

## Equity Capital

The level and composition of our equity capital are principally determined by our consolidated regulatory capital requirements but may also be influenced by rating agency guidelines, subsidiary capital requirements, the business environment, conditions in the financial markets and assessments of potential future losses due to extreme and adverse changes in our business and market environments. As of November 2008, our total shareholders' equity was \$64.37 billion (consisting of common shareholders' equity of \$47.90 billion and preferred stock of \$16.47 billion) compared with total shareholders' equity of \$42.80 billion as of November 2007 (consisting of common shareholders' equity of \$39.70 billion and preferred stock of \$3.10 billion). In addition to total shareholders' equity, we consider the \$5.00 billion of junior subordinated debt issued to trusts (see discussion below) to be part of our equity capital, as it qualifies as capital for regulatory and certain rating agency purposes.

### Consolidated Capital Requirements

We are subject to regulatory capital requirements administered by the U.S. federal banking agencies. Our bank depository institution subsidiaries, including GS Bank USA, are subject to similar capital guidelines. Under the Federal Reserve Board's capital adequacy guidelines and the regulatory framework for prompt corrective action (PCA) that is applicable to GS Bank USA, Goldman Sachs and its bank depository institution subsidiaries must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory reporting practices. Goldman Sachs and its bank depository institution subsidiaries' capital amounts, as well as GS Bank USA's PCA classification, are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. We anticipate reporting capital ratios as follows:

- Before we became a bank holding company, we were subject to capital guidelines by the SEC as a Consolidated Supervised Entity (CSE) that were generally consistent with those set out in the Revised Framework for the International Convergence of Capital Measurement and Capital Standards issued by the Basel Committee on Banking Supervision (Basel II). We currently compute and report our firmwide capital ratios in accordance with the Basel II requirements as applicable to us when we were regulated as a CSE for the purpose of assessing the adequacy of our capital. Under the Basel II framework as it applied to us when we were regulated as a CSE, we evaluate our Tier 1 Capital and Total Allowable Capital as a percentage of RWAs. As of November 2008, our Total Capital Ratio (Total Allowable Capital as a percentage of RWAs) was 18.9% and our Tier 1 Ratio (Tier 1 Capital as a percentage of RWAs) was 15.6%, in each case calculated under the Basel II framework as it applied to us when we were regulated as a CSE. See "— Consolidated Capital Ratios" below for further information. We expect to continue to report to investors for a period of time our Basel II capital ratios as applicable to us when we were regulated as a CSE.
- The regulatory capital guidelines currently applicable to bank holding companies are based on the Capital Accord of the Basel Committee on Banking Supervision (Basel I), with Basel II to be phased in over time. We are currently working with the Federal Reserve Board to put in place the appropriate reporting and compliance mechanisms and methodologies to allow reporting of the Basel I capital ratios as of the end of March 2009.
- In addition, we are currently working to implement the Basel II framework as applicable to us as a bank holding company (as opposed to as a CSE). U.S. banking regulators have incorporated the Basel II framework into the existing risk-based capital requirements by requiring that internationally active banking organizations, such as Group Inc., transition to Basel II over the next several years.

The Federal Reserve Board also has established minimum leverage ratio guidelines. We were not subject to these guidelines before becoming a bank holding company and, accordingly, we are currently working with the Federal Reserve Board to finalize our methodology for calculating this ratio.

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The Tier 1 leverage ratio is defined as Tier 1 capital (as applicable to us as a bank holding company) divided by adjusted average total assets (which includes adjustments for disallowed goodwill and certain intangible assets). The minimum Tier 1 leverage ratio is 3% for bank holding companies that have received the highest supervisory rating under Federal Reserve Board guidelines or that have implemented the Federal Reserve Board's risk-based capital measure for market risk. Other bank holding companies must have a minimum leverage ratio of 4%. Bank holding companies may be expected to maintain ratios well above the minimum levels, depending upon their particular condition, risk profile and growth plans. As of November 2008, our estimated Tier 1 leverage ratio was 6.1%. This ratio represents a preliminary estimate and may be revised in subsequent filings as we continue to work with the Federal Reserve Board to finalize the methodology for the calculation.

### **Consolidated Capital Ratios**

The following table sets forth additional information on our capital ratios as of November 2008 calculated in the same manner (generally consistent with Basel II) as when the firm was regulated by the SEC as a CSE:

	<b>As of November 2008</b>
	(\$ in millions)
<b>I. Tier 1 and Total Allowable Capital</b>	
Common shareholders' equity	\$ 47,898
Preferred stock	16,471
Junior subordinated debt issued to trusts	5,000
Less: Goodwill	(3,523)
Less: Disallowable intangible assets	(1,386)
Less: Other deductions (1)	(1,823)
<b>Tier 1 Capital</b>	<b>62,637</b>
Other components of Total Allowable Capital	
Qualifying subordinated debt (2)	13,703
Less: Other deductions (1)	(690)
<b>Total Allowable Capital</b>	<b>\$ 75,650</b>
<b>II. Risk-Weighted Assets</b>	
Market risk	\$176,646
Credit risk	184,055
Operational risk	39,675
<b>Total Risk-Weighted Assets</b>	<b>\$400,376</b>
<b>III. Tier 1 Ratio</b>	<b>15.6%</b>
<b>IV. Total Capital Ratio</b>	<b>18.9%</b>

(1) Principally included investments in regulated insurance entities and certain financial service entities (50% was deducted from both Tier 1 Capital and Total Allowable Capital).

(2) Substantially all of our existing subordinated debt qualified as Total Allowable Capital for CSE purposes.

Our RWAs are driven by the amount of market risk, credit risk and operational risk associated with our business activities in a manner generally consistent with methodologies set out in Basel II. The methodologies used to compute RWAs for each of market risk, credit risk and operational risk are closely aligned with our risk management practices. See "— Market Risk" and "— Credit Risk" below for a discussion of how we manage risks in our trading and principal investing businesses. Further details on the methodologies used to calculate RWAs are set forth below.



### ***Risk-Weighted Assets for Market Risk***

For positions captured in VaR, RWAs are calculated using VaR and other model-based measures, including requirements for incremental default risk and other event risks. VaR is the potential loss in value of trading positions due to adverse market movements over a defined time horizon with a specified confidence level. Market risk RWAs are calculated consistent with the specific conditions set out in the Basel II framework (based on VaR calibrated to a 99% confidence level, over a 10-day holding period, multiplied by a factor). Additional RWAs are calculated with respect to incremental default risk and other event risks, in a manner generally consistent with our internal risk management methodologies.

For positions not included in VaR because VaR is not the most appropriate measure of risk, we calculate RWAs based on alternative methodologies, including sensitivity analyses.

### ***Risk-Weighted Assets for Credit Risk***

RWAs for credit risk are calculated for on- and off-balance-sheet exposures that are not captured in our market risk RWAs, with the exception of OTC derivatives for which both market risk and credit risk RWAs are calculated. The calculations are consistent with the Advanced Internal Ratings Based (AIRB) approach and the Internal Models Method (IMM) of Basel II, and were based on Exposure at Default (EAD), which is an estimate of the amount that would be owed to us at the time of a default, multiplied by each counterparty's risk weight.

Under the Basel II AIRB approach, a counterparty's risk weight is generally derived from a combination of the Probability of Default (PD), the Loss Given Default (LGD) and the maturity of the trade or portfolio of trades, where:

- PD is an estimate of the probability that an obligor will default over a one-year horizon. PD is derived from the use of internally determined equivalents of public rating agency ratings.
- LGD is an estimate of the economic loss rate if a default occurs during economic downturn conditions. LGD is determined based on industry data.

For OTC derivatives and funding trades (such as repurchase and reverse repurchase transactions), we use the Basel II IMM approach, which allows EAD to be calculated using model-based measures to determine potential exposure, consistent with models and methodologies that we use for internal risk management purposes. For commitments, EAD is calculated as a percentage of the outstanding notional balance. For other credit exposures, EAD is generally the carrying value of the exposure.

### ***Risk-Weighted Assets for Operational Risk***

RWAs for operational risk are calculated using a risk-based methodology consistent with the qualitative and quantitative criteria for the Advanced Measurement Approach (AMA), as defined in Basel II. The methodology incorporates internal loss events, relevant external loss events, results of scenario analyses and management's assessment of our business environment and internal controls. We estimate capital requirements for both expected and unexpected losses, seeking to capture the major drivers of operational risk over a one-year time horizon, at a 99.9% confidence level. Operational risk capital is allocated among our businesses and is regularly reported to senior management and key risk and oversight committees.

### **Rating Agency Guidelines**

The credit rating agencies assign credit ratings to the obligations of Group Inc., which directly issues or guarantees substantially all of the firm's senior unsecured obligations. The level and composition of our equity capital are among the many factors considered in determining our credit ratings. Each agency has its own definition of eligible capital and methodology for evaluating capital

adequacy, and assessments are generally based on a combination of factors rather than a single calculation. See “— Liquidity and Funding Risk — Credit Ratings” below for further information regarding our credit ratings.

### **Subsidiary Capital Requirements**

Many of our subsidiaries are subject to separate regulation and capital requirements in the U.S. and/or elsewhere. GS&Co. and Goldman Sachs Execution & Clearing, L.P. are registered U.S. broker-dealers and futures commissions merchants, and are subject to regulatory capital requirements, including those imposed by the SEC, the Commodity Futures Trading Commission, the Chicago Board of Trade, the Financial Industry Regulatory Authority, Inc. (FINRA) and the National Futures Association.

Our depository institution subsidiary, GS Bank USA, a New York State-chartered bank and a member of the Federal Reserve System and the FDIC, is regulated by the Federal Reserve Board and the New York State Banking Department and is subject to minimum capital requirements that (subject to certain exceptions) are similar to those applicable to bank holding companies. GS Bank USA was formed in November 2008 through the merger of our existing Utah industrial bank (named GS Bank USA) into our New York limited purpose trust company, with the surviving company taking the name GS Bank USA. As of November 2007, GS Bank USA's predecessor was a wholly owned industrial bank regulated by the Utah Department of Financial Institutions, was a member of the FDIC and was subject to minimum capital requirements. We compute the capital ratios for GS Bank USA in accordance with the Basel I framework for purposes of assessing the adequacy of its capital. In order to be considered a “well capitalized” depository institution under the Federal Reserve Board guidelines, GS Bank USA must maintain a Tier 1 capital ratio of at least 6%, a total capital ratio of at least 10%, and a Tier 1 leverage ratio of at least 5%. In connection with the November 2008 asset transfer described below, GS Bank USA agreed with the Federal Reserve Board to minimum capital ratios in excess of these “well capitalized” levels. Accordingly, for a period of time, GS Bank USA is expected to maintain a Tier 1 capital ratio of at least 8%, a total capital ratio of at least 11% and a Tier 1 leverage ratio of at least 6%. In November 2008, we contributed subsidiaries with an aggregate of \$117.16 billion of assets into GS Bank USA (which brought total assets in GS Bank USA to \$145.06 billion as of November 2008). As a result, we are currently working with the Federal Reserve Board to finalize our methodology for the Basel I calculations. As of November 2008, under Basel I, GS Bank USA's estimated Tier 1 capital ratio was 8.9% and estimated total capital ratio was 11.6%. In addition, GS Bank USA's estimated Tier 1 leverage ratio was 9.1%.

Group Inc. has guaranteed the payment obligations of GS&Co., GS Bank USA and GS Bank Europe, subject to certain exceptions. In November 2008, as noted above, we contributed subsidiaries, with an aggregate of \$117.16 billion of assets, into GS Bank USA and Group Inc. agreed to guarantee certain losses, including credit-related losses, relating to assets held by the contributed entities. In connection with this guarantee, Group Inc. also agreed to pledge to GS Bank USA certain collateral, including interests in subsidiaries and other illiquid assets.

GS Bank Europe, our regulated Irish bank, is subject to minimum capital requirements imposed by the Irish Financial Services Regulatory Authority. Several other subsidiaries of Goldman Sachs are regulated by securities, investment advisory, banking, insurance, and other regulators and authorities around the world. Goldman Sachs International (GSI), our regulated U.K. broker-dealer, is subject to minimum capital requirements imposed by the Financial Services Authority (FSA). Goldman Sachs Japan Co., Ltd., our regulated Japanese broker-dealer, is subject to minimum capital requirements imposed by Japan's Financial Services Agency. As of November 2008 and November 2007, these subsidiaries were in compliance with their local capital requirements.

As discussed above, many of our subsidiaries are subject to regulatory capital requirements in jurisdictions throughout the world. Subsidiaries not subject to separate regulation may hold capital to satisfy local tax guidelines, rating agency requirements (for entities with assigned credit ratings) or

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internal policies, including policies concerning the minimum amount of capital a subsidiary should hold based on its underlying level of risk. See “— Liquidity and Funding Risk — Conservative Liability Structure” below for a discussion of our potential inability to access funds from our subsidiaries.

Equity investments in subsidiaries are generally funded with parent company equity capital. As of November 2008, Group Inc.’s equity investment in subsidiaries was \$51.70 billion compared with its total shareholders’ equity of \$64.37 billion.

Our capital invested in non-U.S. subsidiaries is generally exposed to foreign exchange risk, substantially all of which is managed through a combination of derivative contracts and non-U.S. denominated debt. In addition, we generally manage the non-trading exposure to foreign exchange risk that arises from transactions denominated in currencies other than the transacting entity’s functional currency.

See Note 17 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our regulated subsidiaries.

### **Equity Capital Management**

Our objective is to maintain a sufficient level and optimal composition of equity capital. We manage our capital through repurchases of our common stock, as permitted, and issuances of common and preferred stock, junior subordinated debt issued to trusts and other subordinated debt. We manage our capital requirements principally by setting limits on balance sheet assets and/or limits on risk, in each case at both the consolidated and business unit levels. We attribute capital usage to each of our business units based upon our regulatory capital framework and manage the levels of usage based upon the balance sheet and risk limits established.

**Share Repurchase Program.** Subject to the limitations of the U.S. Treasury’s TARP Capital Purchase Program described below under “— Equity Capital — Equity Capital Management — Preferred Stock,” we seek to use our share repurchase program to substantially offset increases in share count over time resulting from employee share-based compensation. The repurchase program is effected primarily through regular open-market purchases, the amounts and timing of which are determined primarily by our current and projected capital positions (i.e., comparisons of our desired level of capital to our actual level of capital) but which may also be influenced by general market conditions and the prevailing price and trading volumes of our common stock, in each case subject to the limit imposed under the U.S. Treasury’s TARP Capital Purchase Program. See “— Equity Capital — Equity Capital Management — Preferred Stock” below for information regarding restrictions on our ability to repurchase common stock.

The following table sets forth the level of share repurchases for the years ended November 2008 and November 2007:

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
	(in millions, except per share amounts)	
Number of shares repurchased	10.54	41.22
Total cost	\$ 2,037	\$ 8,956
Average cost per share	\$193.18	\$217.29

As of November 2008, we were authorized to repurchase up to 60.9 million additional shares of common stock pursuant to our repurchase program. See “Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” in Part II, Item 5 of our Annual Report on Form 10-K for additional information on our repurchase program.

**Stock Offerings.** In September 2008, we completed a public offering of 46.7 million shares of common stock at \$123.00 per share for proceeds of \$5.75 billion.

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In October 2008, we issued to Berkshire Hathaway Inc. and certain affiliates 50,000 shares of 10% Cumulative Perpetual Preferred Stock, Series G (Series G Preferred Stock), and a five-year warrant to purchase up to 43.5 million shares of common stock at an exercise price of \$115.00 per share, for aggregate proceeds of \$5.00 billion. The allocated carrying values of the warrant and the Series G Preferred Stock on the date of issuance (based on their relative fair values) were \$1.14 billion and \$3.86 billion, respectively. The warrant is exercisable at any time until October 1, 2013 and the number of shares of common stock underlying the warrant and the exercise price are subject to adjustment for certain dilutive events.

In October 2008, under the U.S. Treasury's TARP Capital Purchase Program, we issued to the U.S. Treasury 10.0 million shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series H (Series H Preferred Stock), and a 10-year warrant to purchase up to 12.2 million shares of common stock at an exercise price of \$122.90 per share, for aggregate proceeds of \$10.00 billion. The allocated carrying values of the warrant and the Series H Preferred Stock on the date of issuance (based on their relative fair values) were \$490 million and \$9.51 billion, respectively. Cumulative dividends on the Series H Preferred Stock are payable at 5% per annum through November 14, 2013 and at a rate of 9% per annum thereafter. The Series H Preferred Stock will be accreted to the redemption price of \$10.00 billion over five years. The warrant is exercisable at any time until October 28, 2018 and the number of shares of common stock underlying the warrant and the exercise price are subject to adjustment for certain dilutive events. If, on or prior to December 31, 2009, we receive aggregate gross cash proceeds of at least \$10 billion from sales of Tier 1 qualifying perpetual preferred stock or common stock, the number of shares of common stock issuable upon exercise of the warrant will be reduced by one-half of the original number of shares of common stock.

**Preferred Stock.** As of November 2008, Goldman Sachs had 10.2 million shares of perpetual preferred stock issued and outstanding as set forth in the following table:

### Preferred Stock by Series

Series	Dividend Preference	Shares Issued	Shares Authorized	Dividend Rate	Earliest Redemption Date	Redemption Value (in millions)
A	Non-cumulative	30,000	50,000	3 month LIBOR + 0.75%, with floor of 3.75% per annum	April 25, 2010	\$ 750
B	Non-cumulative	32,000	50,000	6.20% per annum	October 31, 2010	800
C	Non-cumulative	8,000	25,000	3 month LIBOR + 0.75%, with floor of 4.00% per annum	October 31, 2010	200
D	Non-cumulative	54,000	60,000	3 month LIBOR + 0.67%, with floor of 4.00% per annum	May 24, 2011	1,350
G	Cumulative	50,000	50,000	10.00% per annum	Date of issuance	5,500
H	Cumulative	10,000,000	10,000,000	5.00% per annum through November 14, 2013 and 9.00% per annum thereafter	Date of issuance	10,000
		<u>10,174,000</u>	<u>10,235,000</u>			<u>\$18,600</u>

Each share of non-cumulative preferred stock issued and outstanding has a par value of \$0.01, has a liquidation preference of \$25,000, is represented by 1,000 depositary shares and is redeemable at our option, subject to the approval of the Federal Reserve Board, at a redemption price equal to \$25,000 plus declared and unpaid dividends.

Each share of Series G Preferred Stock issued and outstanding has a par value of \$0.01, has a liquidation preference of \$100,000 and is redeemable at our option, subject to the approval of the Federal

Reserve Board, at a redemption price equal to \$110,000 plus accrued and unpaid dividends.

Each share of Series H Preferred Stock issued and outstanding has a par value of \$0.01, has a liquidation preference of \$1,000 and is redeemable at our option, subject to the approval of the

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Federal Reserve Board, at a redemption price equal to \$1,000 plus accrued and unpaid dividends, provided that through November 14, 2011 the Series H Preferred Stock is redeemable only in an amount up to the aggregate net cash proceeds received from sales of Tier 1 qualifying perpetual preferred stock or common stock, and only once such sales have resulted in aggregate gross proceeds of at least \$2.5 billion.

All series of preferred stock are *pari passu* and have a preference over our common stock upon liquidation. Dividends on each series of preferred stock, if declared, are payable quarterly in arrears. Our ability to declare or pay dividends on, or purchase, redeem or otherwise acquire, our common stock is subject to certain restrictions in the event that we fail to pay or set aside full dividends on our preferred stock for the latest completed dividend period. In addition, pursuant to the U.S. Treasury's TARP Capital Purchase Program, until the earliest of October 28, 2011, the redemption of all of the Series H Preferred Stock or transfer by the U.S. Treasury of all of the Series H Preferred Stock to third parties, we must obtain the consent of the U.S. Treasury to raise our common stock dividend or to repurchase any shares of common stock or other preferred stock, with certain exceptions (including repurchases of our common stock under our share repurchase program to offset dilution from equity-based compensation). For as long as the Series H Preferred Stock remains outstanding, due to the limitations pursuant to the U.S. Treasury's TARP Capital Purchase Program, we will repurchase our common stock through our share repurchase program only for the purpose of offsetting dilution from equity-based compensation, to the extent permitted.

**Junior Subordinated Debt Issued to Trusts in Connection with Normal Automatic Preferred Enhanced Capital Securities.** In 2007, we issued \$1.75 billion of fixed rate junior subordinated debt to Goldman Sachs Capital II and \$500 million of floating rate junior subordinated debt to Goldman Sachs Capital III, Delaware statutory trusts that, in turn, issued \$2.25 billion of guaranteed perpetual Automatic Preferred Enhanced Capital Securities (APEX) to third parties and a de minimis amount of common securities to Goldman Sachs. The junior subordinated debt is included in "Unsecured long-term borrowings" in the consolidated statements of financial condition. In connection with the APEX issuance, we entered into stock purchase contracts with Goldman Sachs Capital II and III under which we will be obligated to sell and these entities will be obligated to purchase \$2.25 billion of perpetual non-cumulative preferred stock that we will issue in the future. Goldman Sachs Capital II and III are required to remarket the junior subordinated debt in order to fund their purchase of the preferred stock, but in the event that a remarketing is unsuccessful, they will relinquish the subordinated debt to us in exchange for the preferred stock. Because of certain characteristics of the junior subordinated debt (and the associated APEX), including its long-term nature, the future issuance of perpetual non-cumulative preferred stock under the stock purchase contracts, our ability to defer payments due on the debt and the subordinated nature of the debt in our capital structure, it qualifies as Tier 1 and Total Allowable Capital and is included as part of our equity capital.

**Junior Subordinated Debt Issued to a Trust in Connection with Trust Preferred Securities.** We issued \$2.84 billion of junior subordinated debentures in 2004 to Goldman Sachs Capital I, a Delaware statutory trust that, in turn, issued \$2.75 billion of guaranteed preferred beneficial interests to third parties and \$85 million of common beneficial interests to Goldman Sachs. The junior subordinated debentures are included in "Unsecured long-term borrowings" in the consolidated statements of financial condition. Because of certain characteristics of the junior subordinated debt (and the associated trust preferred securities), including its long-term nature, our ability to defer coupon interest for up to ten consecutive semi-annual periods and the subordinated nature of the debt in our capital structure, it qualifies as Tier 1 and Total Allowable Capital and is included as part of our equity capital.

**Subordinated Debt.** In addition to junior subordinated debt issued to trusts, we had other subordinated debt outstanding of \$14.17 billion as of November 2008. Although not part of our shareholders' equity, substantially all of our subordinated debt qualifies as Total Allowable Capital.

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### Other Capital Ratios and Metrics

The following table sets forth information on our assets, shareholders' equity, leverage ratios and book value per common share:

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
	(\$ in millions, except per share amounts)	
Total assets	\$884,547	\$1,119,796
Adjusted assets (1)	528,161	745,700
Total shareholders' equity	64,369	42,800
Tangible equity capital (2)	64,186	42,728
Leverage ratio (3)	13.7x	26.2x
Adjusted leverage ratio (4)	8.2x	17.5x
Debt to equity ratio (5)	2.6x	3.8x
Common shareholders' equity	\$ 47,898	\$ 39,700
Tangible common shareholders' equity (6)	42,715	34,628
Book value per common share (7)	\$ 98.68	\$ 90.43
Tangible book value per common share (8)	88.00	78.88

- (1) Adjusted assets excludes (i) low-risk collateralized assets generally associated with our matched book and securities lending businesses and federal funds sold, (ii) cash and securities we segregate for regulatory and other purposes and (iii) goodwill and identifiable intangible assets, excluding power contracts. We do not deduct identifiable intangible assets associated with power contracts from total assets in order to be consistent with the calculation of tangible equity capital and the adjusted leverage ratio (see footnote 2 below).

The following table sets forth the reconciliation of total assets to adjusted assets:

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
	(in millions)	
Total assets	\$ 884,547	\$ 1,119,796
Deduct: Securities borrowed	(180,795)	(277,413)
Securities purchased under agreements to resell, at fair value and federal funds sold	(122,021)	(87,317)
Add: Trading liabilities, at fair value	175,972	215,023
Less derivative liabilities	(117,695)	(99,378)
Subtotal	58,277	115,645
Deduct: Cash and securities segregated for regulatory and other purposes	(106,664)	(119,939)
Goodwill and identifiable intangible assets, excluding power contracts	(5,183)	(5,072)
Adjusted assets	\$ 528,161	\$ 745,700

- (2) Tangible equity capital equals total shareholders' equity and junior subordinated debt issued to trusts less goodwill and identifiable intangible assets, excluding power contracts. We do not deduct identifiable intangible assets associated with power contracts from total shareholders' equity because, unlike other intangible assets, less than 50% of these assets are supported by common shareholders' equity. 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.

The following table sets forth the reconciliation of total shareholders' equity to tangible equity capital:

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
	(in millions)	
Total shareholders' equity	\$64,369	\$42,800
Add: Junior subordinated debt issued to trusts	5,000	5,000
Goodwill and identifiable intangible assets, excluding power contracts	(5,183)	(5,072)
Tangible equity capital	\$64,186	\$42,728



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- (3) The leverage ratio equals total assets divided by total shareholders' equity. This ratio is different from the Tier 1 leverage ratios included in "— Equity Capital — Consolidated Capital Requirements" and "— Equity Capital — Subsidiary Capital Requirements" above.
- (4) The adjusted leverage ratio equals adjusted assets divided by tangible equity capital. We believe that the adjusted leverage ratio is a more meaningful measure of our capital adequacy than the leverage ratio because it excludes certain low-risk collateralized assets that are generally supported with little or no capital and reflects the tangible equity capital deployed in our businesses.
- (5) The debt to equity ratio equals unsecured long-term borrowings divided by total shareholders' equity.
- (6) Tangible common shareholders' equity equals total shareholders' equity less preferred stock, goodwill and identifiable intangible assets, excluding power contracts. We do not deduct identifiable intangible assets associated with power contracts from total shareholders' equity because, unlike other intangible assets, less than 50% of these assets are supported by common shareholders' equity.

The following table sets forth the reconciliation of total shareholders' equity to tangible common shareholders' equity:

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
	(in millions)	
Total shareholders' equity	\$ 64,369	\$42,800
Deduct: Preferred stock	<u>(16,471)</u>	<u>(3,100)</u>
Common shareholders' equity	47,898	39,700
Deduct: Goodwill and identifiable intangible assets, excluding power contracts	<u>(5,183)</u>	<u>(5,072)</u>
Tangible common shareholders' equity	<u>\$ 42,715</u>	<u>\$34,628</u>

- (7) Book value per common share is based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 485.4 million and 439.0 million as of November 2008 and November 2007, respectively.
- (8) Tangible book value per common share is computed by dividing tangible common shareholders' equity by the number of common shares outstanding, including restricted stock units granted to employees with no future service requirements.

## Contractual Obligations and Commitments

Goldman Sachs has contractual obligations to make future payments related to our unsecured long-term borrowings, secured long-term financings, long-term noncancelable lease agreements and purchase obligations and has commitments under a variety of commercial arrangements.

The following table sets forth our contractual obligations by fiscal maturity date as of November 2008:

### Contractual Obligations (in millions)

	2009	2010- 2011	2012- 2013	2014- Thereafter	Total
Unsecured long-term borrowings (1)(2)(3)	\$ —	\$25,122	\$38,750	\$104,348	\$168,220
Secured long-term financings (1)(2)(4)	—	6,735	4,417	6,306	17,458
Contractual interest payments (5)	8,145	14,681	11,947	34,399	69,172
Insurance liabilities (6)	642	951	791	4,879	7,263
Minimum rental payments	494	800	535	1,664	3,493
Purchase obligations	569	132	21	21	743

(1) Obligations maturing within one year of our financial statement date or redeemable within one year of our financial statement date at the option of the holder are excluded from this table and are treated as short-term obligations. See Note 3 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our secured financings.

(2) Obligations that are repayable prior to maturity at the option of Goldman Sachs are reflected at their contractual maturity dates. Obligations that are redeemable prior to maturity at the option of the holder are reflected at the dates such options become exercisable.

(3) Includes \$17.45 billion accounted for at fair value under SFAS No. 155 or SFAS No. 159, primarily consisting of hybrid financial instruments and prepaid physical commodity transactions.

(4) These obligations are reported within "Other secured financings" in the consolidated statements of financial condition and include \$7.85 billion accounted for at fair value under SFAS No. 159.

(5) Represents estimated future interest payments related to unsecured long-term borrowings and secured long-term financings based on applicable interest rates as of November 2008. Includes stated coupons, if any, on structured notes.

(6) Represents estimated undiscounted payments related to future benefits and unpaid claims arising from policies associated with our insurance activities, excluding separate accounts and estimated recoveries under reinsurance contracts.

As of November 2008, our unsecured long-term borrowings were \$168.22 billion, with maturities extending to 2043, and consisted principally of senior borrowings. See Note 7 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our unsecured long-term borrowings.

As of November 2008, our future minimum rental payments, net of minimum sublease rentals, under noncancelable leases were \$3.49 billion. These lease commitments, principally for office space, expire on various dates through 2069. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges. See Note 8 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our leases.

Our occupancy expenses include costs associated with office space held in excess of our current requirements. This excess space, the cost of which is charged to earnings as incurred, is being held for potential growth or to replace currently occupied space that we may exit in the future. We regularly evaluate our current and future space capacity in relation to current and projected staffing levels. In 2008, we incurred exit costs of \$80 million related to our office space (included in

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“Occupancy” and “Depreciation and Amortization” in the consolidated statement of earnings). We may incur exit costs in the future to the extent we (i) reduce our space capacity or (ii) commit to, or occupy, new properties in the locations in which we operate and, consequently, dispose of existing space that had been held for potential growth. These exit costs may be material to our results of operations in a given period.

As of November 2008, included in purchase obligations was \$483 million of construction-related obligations. Our construction-related obligations include commitments of \$388 million related to our new headquarters in New York City, which is expected to cost between \$2.1 billion and \$2.3 billion. We have partially financed this construction project with \$1.65 billion of tax-exempt Liberty Bonds.

Due to the uncertainty of the timing and amounts that will ultimately be paid, our liability for unrecognized tax benefits has been excluded from the above contractual obligations table. See Note 16 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information on FIN 48.

The following table sets forth our commitments as of November 2008:

### **Commitments** (in millions)

	<b>Commitment Amount by Fiscal Period of Expiration</b>				
	<b>2009</b>	<b>2010- 2011</b>	<b>2012- 2013</b>	<b>2014- Thereafter</b>	<b>Total</b>
Commitments to extend credit					
Commercial lending:					
Investment-grade	\$ 3,587	\$ 2,705	\$ 1,538	\$ 177	\$ 8,007
Non-investment-grade	1,188	1,767	5,708	655	9,318
William Street program	3,300	6,715	12,178	417	22,610
Warehouse financing	604	497	—	—	1,101
Total commitments to extend credit (1)	8,679	11,684	19,424	1,249	41,036
Forward starting resale and securities borrowing agreements	61,455	—	—	—	61,455
Forward starting repurchase and securities lending agreements	6,948	—	—	—	6,948
Commitments under letters of credit issued by banks to counterparties	6,953	101	197	—	7,251
Investment commitments	6,398	7,144	101	623	14,266
Underwriting commitments	241	—	—	—	241
Total	<u>\$90,674</u>	<u>\$18,929</u>	<u>\$19,722</u>	<u>\$1,872</u>	<u>\$131,197</u>

(1) Commitments to extend credit are net of amounts syndicated to third parties.

Our commitments to extend credit are agreements to lend to counterparties that have fixed termination dates and are contingent on the satisfaction of all conditions to borrowing set forth in the contract. In connection with our lending activities, we had outstanding commitments to extend credit of \$41.04 billion as of November 2008. Since these commitments may expire unused or be reduced or cancelled at the counterparty's request, the total commitment amount does not necessarily reflect the actual future cash flow requirements. Our commercial lending commitments are generally extended in connection with contingent acquisition financing and other types of corporate lending as well as commercial real estate financing. We may seek to reduce our credit risk on these commitments by syndicating all or substantial portions of commitments to other investors in the future. In addition,

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commitments that are extended for contingent acquisition financing are often intended to be short-term in nature, as borrowers often seek to replace them with other funding sources.

Included within non-investment-grade commitments as of November 2008 was \$2.07 billion of exposure to leveraged lending capital market transactions, \$164 million related to commercial real estate transactions and \$7.09 billion arising from other unfunded credit facilities. Including funded loans, our total exposure to leveraged lending capital market transactions was \$7.97 billion as of November 2008.

The following table sets forth our exposure to leveraged lending capital market transactions by geographic region:

### **Leveraged Lending Capital Market Exposure by Geographic Region** (in millions)

	As of November 2008		
	Funded	Unfunded	Total
Americas (1)	\$3,036	\$1,735	\$4,771
EMEA (2)	2,294	259	2,553
Asia	568	73	641
Total	<u>\$5,898</u>	<u>\$2,067</u>	<u>\$7,965</u>

(1) Substantially all relates to the U.S.

(2) EMEA (Europe, Middle East and Africa).

Substantially all of the commitments provided under the William Street credit extension program are to investment-grade corporate borrowers. Commitments under the program are principally extended by William Street Commitment Corporation (Commitment Corp.), a consolidated wholly owned subsidiary of GS Bank USA, and also by William Street Credit Corporation, GS Bank USA or Goldman Sachs Credit Partners L.P. The commitments extended by Commitment Corp. are supported, in part, by funding raised by William Street Funding Corporation (Funding Corp.), another consolidated wholly owned subsidiary of GS Bank USA. The assets and liabilities of Commitment Corp. and Funding Corp. are legally separated from other assets and liabilities of the firm. With respect to most of the William Street commitments, SMFG provides us with credit loss protection that is generally limited to 95% of the first loss we realize on approved loan commitments, up to a maximum of \$1.00 billion. In addition, subject to the satisfaction of certain conditions, upon our request, SMFG will provide protection for 70% of additional losses on such commitments, up to a maximum of \$1.13 billion, of which \$375 million of protection has been provided as of November 2008. We also use other financial instruments to mitigate credit risks related to certain William Street commitments not covered by SMFG.

Our commitments to extend credit also include financing for the warehousing of financial assets. These arrangements are secured by the warehoused assets, primarily consisting of commercial mortgages as of November 2008.

See Note 8 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our commitments, contingencies and guarantees.

## Risk Management

Management believes that effective risk management is of primary importance to the success of Goldman Sachs. Accordingly, we have a comprehensive risk management process to monitor, evaluate and manage the principal risks we assume in conducting our activities. These risks include market, credit, liquidity, operational, legal and reputational exposures.

### Risk Management Structure

We seek to monitor and control our risk exposure through a variety of separate but complementary financial, credit, operational, compliance and legal reporting systems. In addition, a number of committees are responsible for monitoring risk exposures and for general oversight of our risk management process, as described further below. These committees (including their subcommittees), meet regularly and consist of senior members of both our revenue-producing units and departments that are independent of our revenue-producing units.

Segregation of duties and management oversight are fundamental elements of our risk management process. In addition to the committees described below, functions that are independent of the revenue-producing units, such as Compliance, Finance, Legal, Management Controls (Internal Audit) and Operations, perform risk management functions, which include monitoring, analyzing and evaluating risk.

**Management Committee.** All risk control functions ultimately report to our Management Committee. Through both direct and delegated authority, the Management Committee approves all of our operating activities and trading risk parameters.

**Risk Committees.** The Firmwide Risk Committee reviews the activities of existing trading businesses, approves new businesses and products, approves firmwide market risk limits, reviews business unit market risk limits, approves market risk limits for selected sovereign markets and business units, approves sovereign credit risk limits and credit risk limits by ratings group, and reviews scenario analyses based on abnormal or “catastrophic” market movements.

The Securities Divisional Risk Committee sets market risk limits for our trading activities subject to overall firmwide risk limits, based on a number of measures, including VaR, stress tests and scenario analyses.

Business unit risk limits are established by the appropriate risk committee and may be further allocated by the business unit managers to individual trading desks. Trading desk managers have the first line of responsibility for managing risk within prescribed limits. These managers have in-depth knowledge of the primary sources of risk in their respective markets and the instruments available to hedge their exposures.

Market risk limits are monitored by the Finance Division and are reviewed regularly by the appropriate risk committee. Limit violations are reported to the appropriate risk committee and business unit managers and addressed, as necessary. Credit risk limits are also monitored by the Finance Division and reviewed by the appropriate risk committee.

The Asset Management Divisional Risk Committee oversees various risk, valuation and credit issues related to our asset management business.

**Business Practices Committee.** The Business Practices Committee assists senior management in its oversight of compliance and operational risks and related reputational concerns, seeks to ensure the consistency of our policies, practices and procedures with our Business Principles, and makes recommendations on ways to mitigate potential risks.

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**Firmwide Capital Committee.** The Firmwide Capital Committee reviews and approves transactions involving commitments of our capital. Such capital commitments include, but are not limited to, extensions of credit, alternative liquidity commitments, certain bond underwritings and certain distressed debt and principal finance activities. The Firmwide Capital Committee is also responsible for establishing business and reputational standards for capital commitments and seeking to ensure that they are maintained on a global basis.

**Commitments Committee.** The Commitments Committee reviews and approves underwriting and distribution activities, primarily with respect to offerings of equity and equity-related securities, and sets and maintains policies and procedures designed to ensure that legal, reputational, regulatory and business standards are maintained in conjunction with these activities. In addition to reviewing specific transactions, the Commitments Committee periodically conducts strategic reviews of industry sectors and products and establishes policies in connection with transaction practices.

**Credit Policy Committee.** The Credit Policy Committee establishes and reviews broad credit policies and parameters that are implemented by the Credit Department.

**Finance Committee.** The Finance Committee establishes and oversees our liquidity policies, sets certain inventory position limits and has oversight responsibility for liquidity risk, the size and composition of our balance sheet and capital base, and our credit ratings. The Finance Committee regularly reviews our funding position and capitalization and makes adjustments in light of current events, risks and exposures.

**New Products Committee.** The New Products Committee, under the oversight of the Firmwide Risk Committee, is responsible for reviewing and approving new products and businesses globally.

**Operational Risk Committee.** The Operational Risk Committee provides oversight of the ongoing development and implementation of our operational risk policies, framework and methodologies, and monitors the effectiveness of operational risk management.

**Structured Products Committee.** The Structured Products Committee reviews and approves structured product transactions entered into with our clients that raise legal, regulatory, tax or accounting issues or present reputational risk to Goldman Sachs.

### **Market Risk**

The potential for changes in the market value of our trading and investing positions is referred to as market risk. Such positions result from market-making, proprietary trading, underwriting, specialist and investing activities. Substantially all of our inventory positions are marked-to-market on a daily basis and changes are recorded in net revenues.

Categories of market risk include exposures to interest rates, equity prices, currency rates and commodity prices. A description of each market risk category is set forth below:

- Interest rate risks primarily result from exposures to changes in the level, slope and curvature of the yield curve, the volatility of interest rates, mortgage prepayment speeds and credit spreads.
- Equity price risks result from exposures to changes in prices and volatilities of individual equities, equity baskets and equity indices.
- Currency rate risks result from exposures to changes in spot prices, forward prices and volatilities of currency rates.
- Commodity price risks result from exposures to changes in spot prices, forward prices and volatilities of commodities, such as electricity, natural gas, crude oil, petroleum products, and precious and base metals.



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We seek to manage these risks by diversifying exposures, controlling position sizes and establishing economic hedges in related securities or derivatives. For example, we may seek to hedge a portfolio of common stocks by taking an offsetting position in a related equity-index futures contract. The ability to manage an exposure may, however, be limited by adverse changes in the liquidity of the security or the related hedge instrument and in the correlation of price movements between the security and related hedge instrument.

In addition to applying business judgment, senior management uses a number of quantitative tools to manage our exposure to market risk for “Trading assets, at fair value” and “Trading liabilities, at fair value” in the consolidated statements of financial condition. These tools include:

- risk limits based on a summary measure of market risk exposure referred to as VaR;
- scenario analyses, stress tests and other analytical tools that measure the potential effects on our trading net revenues of various market events, including, but not limited to, a large widening of credit spreads, a substantial decline in equity markets and significant moves in selected emerging markets; and
- inventory position limits for selected business units.

### **VaR**

VaR is the potential loss in value of trading positions due to adverse market movements over a defined time horizon with a specified confidence level.

For the VaR numbers reported below, a one-day time horizon and a 95% confidence level were used. This means that there is a 1 in 20 chance that daily trading net revenues will fall below the expected daily trading net revenues by an amount at least as large as the reported VaR. Thus, shortfalls from expected trading net revenues on a single trading day greater than the reported VaR would be anticipated to occur, on average, about once a month. Shortfalls on a single day can exceed reported VaR by significant amounts. Shortfalls can also occur more frequently or accumulate over a longer time horizon such as a number of consecutive trading days.

The modeling of the risk characteristics of our trading positions involves a number of assumptions and approximations. While we believe that these assumptions and approximations are reasonable, there is no standard methodology for estimating VaR, and different assumptions and/or approximations could produce materially different VaR estimates.

We use historical data to estimate our VaR and, to better reflect current asset volatilities, we generally weight historical data to give greater importance to more recent observations. Given its reliance on historical data, VaR is most effective in estimating risk exposures in markets in which there are no sudden fundamental changes or shifts in market conditions. An inherent limitation of VaR is that the distribution of past changes in market risk factors may not produce accurate predictions of future market risk. Different VaR methodologies and distributional assumptions could produce a materially different VaR. Moreover, VaR calculated for a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or offset with hedges within one day.

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The following tables set forth the daily VaR:

### **Average Daily VaR (1)** (in millions)

<b>Risk Categories</b>	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Interest rates	\$ 142	\$ 85	\$ 49
Equity prices	72	100	72
Currency rates	30	23	21
Commodity prices	44	26	30
Diversification effect (2)	(108)	(96)	(71)
<b>Total</b>	<b>\$ 180</b>	<b>\$ 138</b>	<b>\$ 101</b>

(1) Certain portfolios and individual positions are not included in VaR, where VaR is not the most appropriate measure of risk (e.g., due to transfer restrictions and/or illiquidity). See "— Other Market Risk Measures" below.

(2) Equals the difference between total VaR and the sum of the VaRs for the four risk categories. This effect arises because the four market risk categories are not perfectly correlated.

Our average daily VaR increased to \$180 million in 2008 from \$138 million in 2007, principally due to increases in the interest rate, commodity price and currency rate categories, partially offset by a decrease in the equity price category. The increase in interest rates was primarily due to higher levels of volatility and wider spreads, partially offset by position reductions, and the increases in commodity prices and currency rates were primarily due to higher levels of volatility. The decrease in equity prices was principally due to position reductions, partially offset by higher levels of volatility.

Our average daily VaR increased to \$138 million in 2007 from \$101 million in 2006. The increase was primarily due to higher levels of exposure and volatility in interest rates and equity prices.

VaR excludes the impact of changes in counterparty and our own credit spreads on derivatives as well as changes in our own credit spreads on unsecured borrowings for which the fair value option was elected. The estimated sensitivity of our net revenues to a one basis point increase in credit spreads (counterparty and our own) on derivatives was \$1 million as of November 2008. In addition, the estimated sensitivity of our net revenues to a one basis point increase in our own credit spreads on unsecured borrowings for which the fair value option was elected was \$1 million (including hedges) as of November 2008.

### **Daily VaR (1)** (in millions)

<b>Risk Categories</b>	<b>As of November</b>		<b>Year Ended November 2008</b>	
	<b>2008</b>	<b>2007</b>	<b>High</b>	<b>Low</b>
Interest rates	\$228	\$ 105	\$228	\$ 93
Equity prices	38	82	234	36
Currency rates	36	35	55	17
Commodity prices	33	33	68	25
Diversification effect (2)	(91)	(121)		
<b>Total</b>	<b>\$244</b>	<b>\$ 134</b>	<b>\$246</b>	<b>\$ 129</b>

(1) Certain portfolios and individual positions are not included in VaR, where VaR is not the most appropriate measure of risk (e.g., due to transfer restrictions and/or illiquidity). See "— Other Market Risk Measures" below.

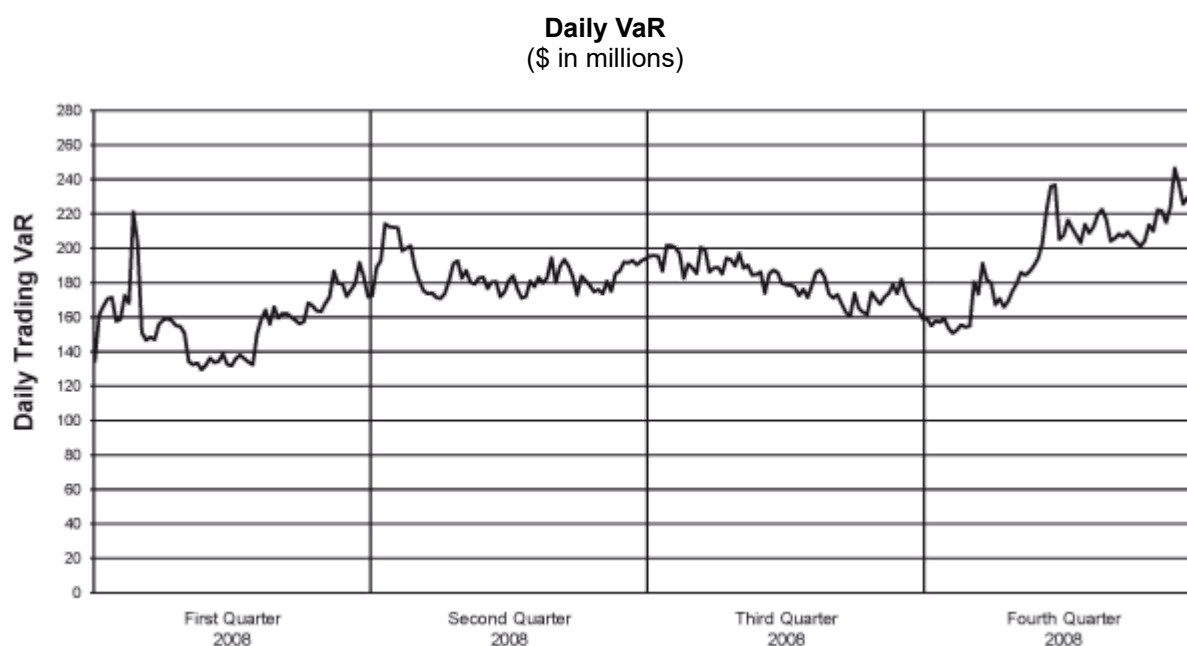
(2) Equals the difference between total VaR and the sum of the VaRs for the four risk categories. This effect arises because the four market risk categories are not perfectly correlated.



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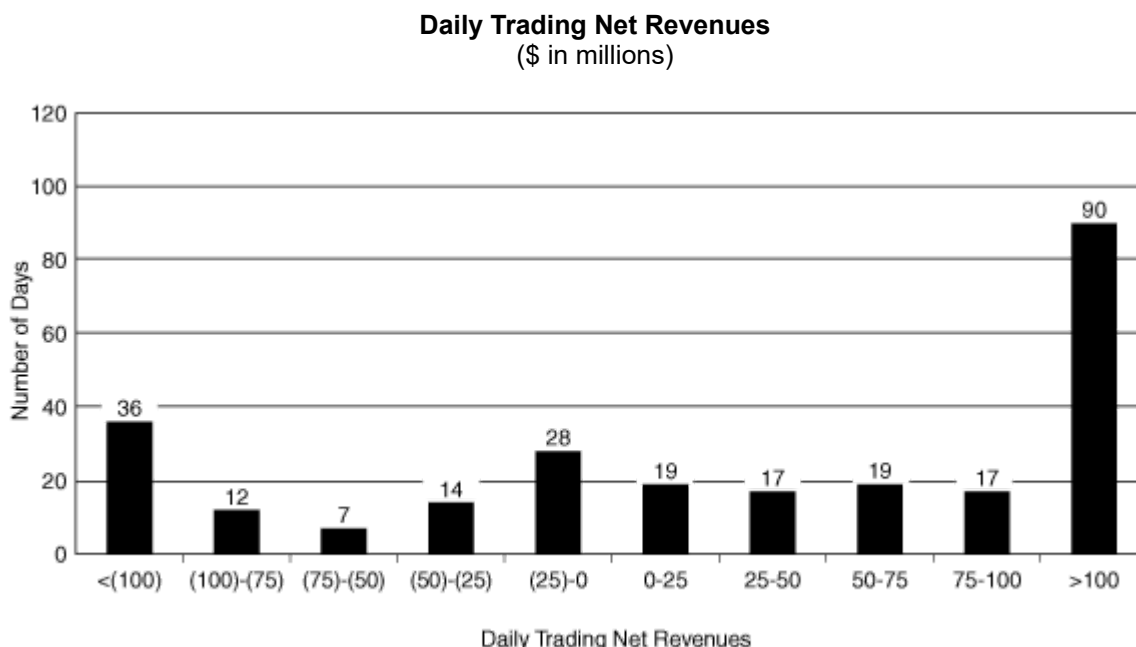
Our daily VaR increased to \$244 million as of November 2008 from \$134 million as of November 2007, primarily due to an increase in the interest rate category and a reduction in the diversification benefit across risk categories, partially offset by a decrease in the equity price category. The increase in interest rates was principally due to higher levels of volatility and wider spreads, partially offset by position reductions. The decrease in equity prices was primarily due to position reductions, partially offset by higher levels of volatility.

The following chart presents our daily VaR during 2008:



### **Trading Net Revenues Distribution**

The following chart sets forth the frequency distribution of our daily trading net revenues for substantially all inventory positions included in VaR for the year ended November 2008:



As part of our overall risk control process, daily trading net revenues are compared with VaR calculated as of the end of the prior business day. Trading losses incurred on a single day exceeded our 95% one-day VaR on 13 and 10 occasions during 2008 and 2007, respectively.

### **Other Market Risk Measures**

Certain portfolios and individual positions are not included in VaR, where VaR is not the most appropriate measure of risk (e.g., due to transfer restrictions and/or illiquidity). The market risk related to our investment in the ordinary shares of ICBC, excluding interests held by investment funds managed by Goldman Sachs, is measured by estimating the potential reduction in net revenues associated with a 10% decline in the ICBC ordinary share price. The market risk related to the remaining positions is measured by estimating the potential reduction in net revenues associated with a 10% decline in asset values.

The sensitivity analyses for equity and debt positions in our trading portfolio and equity, debt (primarily mezzanine instruments) and real estate positions in our non-trading portfolio are measured by the impact of a decline in the asset values (including the impact of leverage in the underlying investments for real estate positions in our non-trading portfolio) of such positions. The fair value of the underlying positions may be impacted by factors such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt capital markets, and changes in financial ratios or cash flows.

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The following table sets forth market risk for positions not included in VaR. These measures do not reflect diversification benefits across asset categories and, given the differing likelihood of the potential declines in asset categories, these measures have not been aggregated:

		10% Sensitivity	
		Amount as of November	
Asset Categories	10% Sensitivity Measure	2008	2007
(in millions)			
<u>Trading Risk</u> (1)			
Equity (2)	Underlying asset value	\$ 790	\$1,325
Debt (3)	Underlying asset value	808	1,020
<u>Non-trading Risk</u>			
ICBC	ICBC ordinary share price	202	250
Other Equity (4)	Underlying asset value	1,155	1,054
Debt (5)	Underlying asset value	694	500
Real Estate (6)	Underlying asset value	1,330	1,108

(1) In addition to the positions in these portfolios, which are accounted for at fair value, we make investments accounted for under the equity method and we also make direct investments in real estate, both of which are included in "Other assets" in the consolidated statements of financial condition. Direct investments in real estate are accounted for at cost less accumulated depreciation. See Note 12 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for information on "Other assets."

(2) Relates to private and restricted public equity securities held within the FICC and Equities components of our Trading and Principal Investments segment.

(3) Relates to acquired portfolios of distressed loans (primarily backed by commercial and residential real estate collateral), bank loans and bridge loans, and loans backed by commercial real estate and held within the FICC component of our Trading and Principal Investments segment.

(4) Primarily relates to interests in our merchant banking funds that invest in corporate equities.

(5) Primarily relates to interests in our merchant banking funds that invest in corporate mezzanine debt instruments.

(6) Primarily relates to interests in our merchant banking funds that invest in real estate. Such funds typically employ leverage as part of the investment strategy. This sensitivity measure is based on our percentage ownership of the underlying asset values in the funds and unfunded commitments to the funds.

The decrease in our 10% sensitivity measures as of November 2008 from November 2007 for equity and debt positions in our trading portfolio was due to dispositions and a decrease in the fair value of the portfolio, partially offset by new investments. The increase in our 10% sensitivity measures as of November 2008 from November 2007 for our non-trading portfolio (excluding ICBC) was due to new investments, partially offset by a decrease in the fair value of the portfolio.

In addition to the positions included in VaR and the other risk measures described above, as of November 2008, we held approximately \$10.39 billion of financial instruments in our bank and insurance subsidiaries, primarily consisting of \$3.08 billion of U.S. government, federal agency and sovereign obligations, \$2.87 billion of corporate debt securities and other debt obligations, \$2.86 billion of money market instruments, and \$1.22 billion of mortgage and other asset-backed loans and securities. As of November 2007, we held approximately \$10.58 billion of financial instruments in our bank and insurance subsidiaries, primarily consisting of \$4.70 billion of mortgage and other asset-backed loans and securities, \$2.93 billion of corporate debt securities and other debt obligations and \$2.77 billion of U.S. government, federal agency and sovereign obligations. In addition, as of November 2008 and November 2007, we held commitments and loans under the William Street credit extension program. See "— Contractual Obligations and Commitments — Commitments" above for information on our William Street program.

## Credit Risk

Credit risk represents the loss that we would incur if a counterparty or an issuer of securities or other instruments we hold fails to perform under its contractual obligations to us, or upon a deterioration in the credit quality of third parties whose securities or other instruments, including OTC derivatives, we hold. Our exposure to credit risk principally arises through our trading, investing and financing activities. To reduce our credit exposures, we seek to enter into netting agreements with counterparties that permit us to offset receivables and payables with such counterparties. In addition, we attempt to further reduce credit risk with certain counterparties by (i) entering into agreements that enable us to obtain collateral from a counterparty on an upfront or contingent basis, (ii) seeking third-party guarantees of the counterparty's obligations, and/or (iii) transferring our credit risk to third parties using credit derivatives and/or other structures and techniques.

To measure and manage our credit exposures, we use a variety of tools, including credit limits referenced to both current exposure and potential exposure. Potential exposure is an estimate of exposure, within a specified confidence level, that could be outstanding over the life of a transaction based on market movements. In addition, as part of our market risk management process, for positions measured by changes in credit spreads, we use VaR and other sensitivity measures. To supplement our primary credit exposure measures, we also use scenario analyses, such as credit spread widening scenarios, stress tests and other quantitative tools.

Our global credit management systems monitor credit exposure to individual counterparties and on an aggregate basis to counterparties and their affiliates. These systems also provide management, including the Firmwide Risk and Credit Policy Committees, with information regarding credit risk by product, industry sector, country and region.

While our activities expose us to many different industries and counterparties, we routinely execute a high volume of transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks and investment funds, resulting in significant credit concentration with respect to this industry. In the ordinary course of business, we may also be subject to a concentration of credit risk to a particular counterparty, borrower or issuer.

As of November 2008 and November 2007, we held \$53.98 billion (6% of total assets) and \$45.75 billion (4% of total assets), respectively, of U.S. government and federal agency obligations included in "Trading assets, at fair value" and "Cash and securities segregated for regulatory and other purposes" in the consolidated statements of financial condition. As of November 2008 and November 2007, we held \$21.13 billion (2% of total assets) and \$31.65 billion (3% of total assets), respectively, of other sovereign obligations, principally consisting of securities issued by the governments of Japan and the United Kingdom. In addition, as of November 2008 and November 2007, \$126.27 billion and \$144.92 billion of our securities purchased under agreements to resell and securities borrowed (including those in "Cash and securities segregated for regulatory and other purposes"), respectively, were collateralized by U.S. government and federal agency obligations. As of November 2008 and November 2007, \$65.37 billion and \$41.26 billion of our securities purchased under agreements to resell and securities borrowed, respectively, were collateralized by other sovereign obligations. As of November 2008 and November 2007, we did not have credit exposure to any other counterparty that exceeded 2% of our total assets. However, over the past several years, the amount and duration of our credit exposures with respect to OTC derivatives has been increasing, due to, among other factors, the growth of our OTC derivative activities and market evolution toward longer-dated transactions. A further discussion of our derivative activities follows below.



## **Derivatives**

Derivative contracts are instruments, such as futures, forwards, swaps or option contracts, that derive their value from underlying assets, indices, reference rates or a combination of these factors. Derivative instruments may be privately negotiated contracts, which are often referred to as OTC derivatives, or they may be listed and traded on an exchange.

Substantially all of our derivative transactions are entered into to facilitate client transactions, to take proprietary positions or as a means of risk management. In addition to derivative transactions entered into for trading purposes, we enter into derivative contracts to manage currency exposure on our net investment in non-U.S. operations and to manage the interest rate and currency exposure on our long-term borrowings and certain short-term borrowings.

Derivatives are used in many of our businesses, and we believe that the associated market risk can only be understood relative to all of the underlying assets or risks being hedged, or as part of a broader trading strategy. Accordingly, the market risk of derivative positions is managed together with our nonderivative positions.

The fair value of our derivative contracts is reflected net of cash paid or received pursuant to credit support agreements and is reported on a net-by-counterparty basis in our consolidated statements of financial condition when we believe a legal right of setoff exists under an enforceable netting agreement. For an OTC derivative, our credit exposure is directly with our counterparty and continues until the maturity or termination of such contract.

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The following tables set forth the fair values of our OTC derivative assets and liabilities by product and by remaining contractual maturity:

### OTC Derivatives (in millions)

Assets	As of November 2008				
	0-12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total
Contract Type					
Interest rates	\$16,220	\$ 43,864	\$35,050	\$40,649	\$ 135,783
Credit derivatives	10,364	45,596	20,110	13,788	89,858
Currencies	28,056	12,191	5,980	4,137	50,364
Commodities	13,660	12,717	1,175	1,681	29,233
Equities	17,830	4,742	3,927	1,061	27,560
Netting across contract types (1)	(6,238)	(9,160)	(3,515)	(3,802)	(22,715)
Subtotal	<u>\$79,892</u> (4)	<u>\$109,950</u>	<u>\$62,727</u>	<u>\$57,514</u>	\$ 310,083
Cross maturity netting (2)					(48,750)
Cash collateral netting (3)					(137,160)
Total					<u>\$ 124,173</u>

Liabilities	0-12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total
Contract Type					
Interest rates	\$ 8,004	\$ 16,152	\$17,456	\$26,399	\$ 68,011
Credit derivatives	6,591	20,958	10,301	13,610	51,460
Currencies	29,130	13,755	4,109	2,051	49,045
Commodities	12,685	10,391	1,575	827	25,478
Equities	14,016	4,741	1,751	320	20,828
Netting across contract types (1)	(6,238)	(9,160)	(3,515)	(3,802)	(22,715)
Subtotal	<u>\$64,188</u> (4)	<u>\$ 56,837</u>	<u>\$31,677</u>	<u>\$39,405</u>	\$ 192,107
Cross maturity netting (2)					(48,750)
Cash collateral netting (3)					(34,009)
Total					<u>\$ 109,348</u>

(1) Represents the netting of receivable balances with payable balances for the same counterparty across contract types within a maturity category, pursuant to credit support agreements.

(2) Represents the netting of receivable balances with payable balances for the same counterparty across maturity categories, pursuant to credit support agreements.

(3) Represents the netting of cash collateral received and posted on a counterparty basis pursuant to credit support agreements.

(4) Includes fair values of OTC derivative assets and liabilities, maturing within six months, of \$56.72 billion and \$51.26 billion, respectively.

**OTC Derivatives**  
(in millions)

Assets	As of November 2007				
	0-12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total
<b>Contract Type</b>					
Interest rates	\$ 8,703	\$10,965	\$17,176	\$28,388	\$ 65,232
Credit derivatives	11,168	13,006	6,501	20,163	50,838
Currencies	20,586	9,275	5,106	2,127	37,094
Commodities	6,264	12,064	1,766	899	20,993
Equities	13,845	5,312	4,273	1,603	25,033
Netting across contract types (1)	<u>(3,355)</u>	<u>(5,665)</u>	<u>(3,132)</u>	<u>(2,066)</u>	<u>(14,218)</u>
Subtotal	<u>\$57,211</u> (4)	<u>\$44,957</u>	<u>\$31,690</u>	<u>\$51,114</u>	\$184,972
Cross maturity netting (2)					(33,849)
Cash collateral netting (3)					<u>(59,050)</u>
Total					<u>\$ 92,073</u>

Liabilities	0-12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total
<b>Contract Type</b>					
Interest rates	\$10,234	\$10,802	\$ 9,816	\$10,287	\$ 41,139
Credit derivatives	7,085	11,842	5,084	16,077	40,088
Currencies	16,560	9,815	1,446	1,772	29,593
Commodities	8,752	9,690	2,757	506	21,705
Equities	17,460	7,723	3,833	1,382	30,398
Netting across contract types (1)	<u>(3,355)</u>	<u>(5,665)</u>	<u>(3,132)</u>	<u>(2,066)</u>	<u>(14,218)</u>
Subtotal	<u>\$56,736</u> (4)	<u>\$44,207</u>	<u>\$19,804</u>	<u>\$27,958</u>	\$148,705
Cross maturity netting (2)					(33,849)
Cash collateral netting (3)					<u>(27,758)</u>
Total					<u>\$ 87,098</u>

(1) Represents the netting of receivable balances with payable balances for the same counterparty across contract types within a maturity category, pursuant to credit support agreements.

(2) Represents the netting of receivable balances with payable balances for the same counterparty across maturity categories, pursuant to credit support agreements.

(3) Represents the netting of cash collateral received and posted on a counterparty basis pursuant to credit support agreements.

(4) Includes fair values of OTC derivative assets and liabilities, maturing within six months, of \$41.80 billion and \$41.12 billion, respectively.

In the tables above, for option contracts that require settlement by delivery of an underlying derivative instrument, the remaining contractual maturity is generally classified based upon the maturity date of the underlying derivative instrument. In those instances where the underlying instrument does not have a maturity date or either counterparty has the right to settle in cash, the remaining contractual maturity is generally based upon the option expiration date.

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The following tables set forth the distribution, by credit rating, of our exposure with respect to OTC derivatives by remaining contractual maturity, both before and after consideration of the effect of collateral and netting agreements. The categories shown reflect our internally determined public rating agency equivalents:

### OTC Derivative Credit Exposure (in millions)

Credit Rating Equivalent	As of November 2008						Exposure	
	0-12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total	Netting (2)	Exposure	Net of Collateral
AAA/Aaa	\$ 5,700	\$ 7,000	\$ 4,755	\$ 2,726	\$ 20,181	\$ (6,765)	\$ 13,416	\$12,328
AA/Aa2	26,040	37,378	30,293	18,084	111,795	(78,085)	33,710	29,438
A/A2	22,374	34,796	15,317	20,498	92,985	(58,744)	34,241	28,643
BBB/Baa2	11,844	19,200	7,635	13,302	51,981	(29,791)	22,190	16,155
BB/Ba2 or lower	13,161	10,403	4,035	2,711	30,310	(12,515)	17,795	11,212
Unrated	773	1,173	692	193	2,831	(10)	2,821	1,550
Total	<u>\$79,892 (1)</u>	<u>\$109,950</u>	<u>\$62,727</u>	<u>\$57,514</u>	<u>\$310,083</u>	<u>\$ (185,910)</u>	<u>\$124,173</u>	<u>\$99,326</u>

Credit Rating Equivalent	As of November 2007						Exposure	
	0-12 Months	1 - 5 Years	5 - 10 Years	10 Years or Greater	Total	Netting (2)	Exposure	Net of Collateral
AAA/Aaa	\$ 6,018	\$ 3,354	\$ 2,893	\$ 7,875	\$ 20,140	\$ (3,600)	\$ 16,540	\$14,453
AA/Aa2	19,331	14,339	13,184	22,708	69,562	(40,661)	28,901	24,758
A/A2	14,491	13,380	10,012	15,133	53,016	(32,453)	20,563	16,010
BBB/Baa2	4,059	5,774	1,707	2,777	14,317	(4,437)	9,880	6,542
BB/Ba2 or lower	6,854	5,676	3,347	2,541	18,418	(4,834)	13,584	7,366
Unrated	6,458	2,434	547	80	9,519	(6,914)	2,605	1,280
Total	<u>\$57,211 (1)</u>	<u>\$ 44,957</u>	<u>\$31,690</u>	<u>\$51,114</u>	<u>\$184,972</u>	<u>\$ (92,899)</u>	<u>\$ 92,073</u>	<u>\$70,409</u>

(1) Includes fair values of OTC derivative assets, maturing within six months, of \$56.72 billion and \$41.80 billion as of November 2008 and November 2007, respectively.

(2) Represents the netting of receivable balances with payable balances for the same counterparty across maturity categories and the netting of cash collateral received, pursuant to credit support agreements. Receivable and payable balances with the same counterparty in the same maturity category are netted within such maturity category, where appropriate.

Derivative transactions may also involve legal risks including the risk that they are not authorized or appropriate for a counterparty, that documentation has not been properly executed or that executed agreements may not be enforceable against the counterparty. We attempt to minimize these risks by obtaining advice of counsel on the enforceability of agreements as well as on the authority of a counterparty to effect the derivative transaction. In addition, certain derivative transactions (e.g., credit derivative contracts) involve the risk that we may have difficulty obtaining, or be unable to obtain, the underlying security or obligation in order to satisfy any physical settlement requirement.

## **Liquidity and Funding Risk**

Liquidity is of critical importance to companies in the financial services sector. Most failures of financial institutions have occurred in large part due to insufficient liquidity resulting from adverse circumstances. Accordingly, Goldman Sachs has in place a comprehensive set of liquidity and funding policies that are intended to maintain significant flexibility to address both Goldman Sachs-specific and broader industry or market liquidity events. Our principal objective is to be able to fund Goldman Sachs and to enable our core businesses to continue to generate revenues, even under adverse circumstances.

We have implemented a number of policies according to the following liquidity risk management framework:

- **Excess Liquidity** — We maintain substantial excess liquidity to meet a broad range of potential cash outflows in a stressed environment, including financing obligations.
- **Asset-Liability Management** — We seek to maintain secured and unsecured funding sources that are sufficiently long-term in order to withstand a prolonged or severe liquidity-stressed environment without having to rely on asset sales.
- **Conservative Liability Structure** — We seek to access funding across a diverse range of markets, products and counterparties, emphasize less credit-sensitive sources of funding and conservatively manage the distribution of funding across our entity structure.
- **Crisis Planning** — We base our liquidity and funding management on stress-scenario planning and maintain a crisis plan detailing our response to a liquidity-threatening event.

### ***Excess Liquidity***

Our most important liquidity policy is to pre-fund what we estimate will be our likely cash needs during a liquidity crisis and hold such excess liquidity in the form of unencumbered, highly liquid securities that may be sold or pledged to provide same-day liquidity. This “Global Core Excess” is intended to allow us to meet immediate obligations without needing to sell other assets or depend on additional funding from credit-sensitive markets. We believe that this pool of excess liquidity provides us with a resilient source of funds and gives us significant flexibility in managing through a difficult funding environment. Our Global Core Excess reflects the following principles:

- The first days or weeks of a liquidity crisis are the most critical to a company’s survival.
- Focus must be maintained on all potential cash and collateral outflows, not just disruptions to financing flows. Goldman Sachs’ businesses are diverse, and its cash needs are driven by many factors, including market movements, collateral requirements and client commitments, all of which can change dramatically in a difficult funding environment.
- During a liquidity crisis, credit-sensitive funding, including unsecured debt and some types of secured financing agreements, may be unavailable, and the terms or availability of other types of secured financing may change.
- As a result of our policy to pre-fund liquidity that we estimate may be needed in a crisis, we hold more unencumbered securities and have larger unsecured debt balances than our businesses would otherwise require. We believe that our liquidity is stronger with greater balances of highly liquid unencumbered securities, even though it increases our unsecured liabilities and our funding costs.

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The size of our Global Core Excess is based on an internal liquidity model together with a qualitative assessment of the condition of the financial markets and of Goldman Sachs. Our liquidity model identifies and estimates cash and collateral outflows over a short-term horizon in a liquidity crisis, including, but not limited to:

- upcoming maturities of unsecured debt and letters of credit;
- potential buybacks of a portion of our outstanding negotiable unsecured debt and potential withdrawals of client deposits;
- adverse changes in the terms or availability of secured funding;
- derivatives and other margin and collateral outflows, including those due to market moves;
- potential cash outflows associated with our prime brokerage business;
- additional collateral that could be called in the event of a two-notch downgrade in our credit ratings;
- draws on our unfunded commitments not supported by William Street Funding Corporation (1); and
- upcoming cash outflows, such as tax and other large payments.

The following table sets forth the average loan value (the estimated amount of cash that would be advanced by counterparties against these securities), as well as overnight cash deposits, of our Global Core Excess:

	<b>Year Ended November</b>	
	<b>2008</b>	<b>2007</b>
	(in millions)	
U.S. dollar-denominated	\$78,048	\$52,115
Non-U.S. dollar-denominated	18,677	11,928
Total Global Core Excess (2)	<u>\$96,725</u>	<u>\$64,043</u>

The U.S. dollar-denominated excess is comprised of only unencumbered U.S. government securities, U.S. agency securities and highly liquid U.S. agency mortgage-backed securities, all of which are eligible as collateral in Federal Reserve open market operations, as well as overnight cash deposits. Our non-U.S. dollar-denominated excess is comprised of only unencumbered French, German, United Kingdom and Japanese government bonds and overnight cash deposits in highly liquid currencies. We strictly limit our Global Core Excess to this narrowly defined list of securities and cash because we believe they are highly liquid, even in a difficult funding environment. We do not believe other potential sources of excess liquidity, such as lower-quality unencumbered securities or committed credit facilities, are as reliable in a liquidity crisis.

We maintain our Global Core Excess to enable us to meet current and potential liquidity requirements of our parent company, Group Inc., and all of its subsidiaries. The amount of our Global Core Excess is driven by our assessment of potential cash and collateral outflows, regulatory obligations and the currency and timing requirements of our global business model. In addition, we recognize that our Global Core Excess held in a regulated entity may not be available to our parent company or other subsidiaries and therefore may only be available to meet the potential liquidity requirements of that entity.

(1) The Global Core Excess excludes liquid assets of \$4.40 billion held separately by William Street Funding Corporation. See “— Contractual Obligations and Commitments” above for a further discussion of the William Street credit extension program.

(2) Beginning in 2008, our Global Core Excess as presented includes the Global Core Excess of GS Bank USA and GS Bank Europe. The 2007 amounts include \$3.48 billion of Global Core Excess at GS Bank USA.

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In addition to our Global Core Excess, we have a significant amount of other unencumbered securities as a result of our business activities. These assets, which are located in the U. S., Europe and Asia, include other government bonds, high-grade money market securities, corporate bonds and marginable equities. We do not include these securities in our Global Core Excess.

We maintain our Global Core Excess and other unencumbered assets in an amount that, if pledged or sold, would provide the funds necessary to replace at least 110% of our unsecured obligations that are scheduled to mature (or where holders have the option to redeem) within the next 12 months. We assume conservative loan values that are based on stress-scenario borrowing capacity and we regularly review these assumptions asset class by asset class. The estimated aggregate loan value of our Global Core Excess, as well as overnight cash deposits, and our other unencumbered assets averaged \$163.41 billion and \$156.74 billion for the fiscal years ended November 2008 and November 2007, respectively.

### ***Asset-Liability Management***

We seek to maintain a highly liquid balance sheet and substantially all of our inventory is marked-to-market daily. We utilize aged inventory limits for certain financial instruments as a disincentive to our businesses to hold inventory over longer periods of time. We believe that these limits provide a complementary mechanism for ensuring appropriate balance sheet liquidity in addition to our standard position limits. Although our balance sheet fluctuates due to client activity, market conventions and periodic market opportunities in certain of our businesses, our total assets and adjusted assets at financial statement dates are typically not materially different from those occurring within our reporting periods.

We seek to manage the maturity profile of our secured and unsecured funding base such that we should be able to liquidate our assets prior to our liabilities coming due, even in times of prolonged or severe liquidity stress. We do not rely on immediate sales of assets (other than our Global Core Excess) to maintain liquidity in a distressed environment, although we recognize orderly asset sales may be prudent or necessary in a severe or persistent liquidity crisis.

In order to avoid reliance on asset sales, our goal is to ensure that we have sufficient total capital (unsecured long-term borrowings plus total shareholders' equity) to fund our balance sheet for at least one year. The target amount of our total capital is based on an internal liquidity model, which incorporates, among other things, the following long-term financing requirements:

- the portion of trading assets that we believe could not be funded on a secured basis in periods of market stress, assuming conservative loan values;
- goodwill and identifiable intangible assets, property, leasehold improvements and equipment, and other illiquid assets;
- derivative and other margin and collateral requirements;
- anticipated draws on our unfunded loan commitments; and
- capital or other forms of financing in our regulated subsidiaries that are in excess of their long-term financing requirements. See “— Conservative Liability Structure” below for a further discussion of how we fund our subsidiaries.



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Certain financial instruments may be more difficult to fund on a secured basis during times of market stress. Accordingly, we generally hold higher levels of total capital for these assets than more liquid types of financial instruments. The following table sets forth our aggregate holdings in these categories of financial instruments:

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
	(in millions)	
Mortgage and other asset-backed loans and securities	\$22,393	\$46,436 (6)
Bank loans and bridge loans (1)	21,839	49,154
Emerging market debt securities	2,827	3,343
High-yield and other debt obligations	9,998	12,807
Private equity and real estate fund investments (2)	18,171	16,244
Emerging market equity securities	2,665	8,014
ICBC ordinary shares (3)	5,496	6,807
SMFG convertible preferred stock (4)	1,135	4,060
Other restricted public equity securities	568	3,455
Other investments in funds (5)	2,714	3,437

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- (1) Includes funded commitments and inventory held in connection with our origination and secondary trading activities.
- (2) Includes interests in our merchant banking funds. Such amounts exclude assets related to consolidated investment funds of \$1.16 billion and \$8.13 billion as of November 2008 and November 2007, respectively, for which Goldman Sachs does not bear economic exposure.
- (3) Includes interests of \$3.48 billion and \$4.30 billion as of November 2008 and November 2007, respectively, held by investment funds managed by Goldman Sachs.
- (4) During our second quarter of 2008, we converted one-third of our SMFG preferred stock investment into SMFG common stock, and delivered the common stock to close out one-third of our hedge position.
- (5) Includes interests in other investment funds that we manage.
- (6) Excludes \$7.64 billion as of November 2007 of mortgage whole loans that were transferred to securitization vehicles where such transfers were accounted for as secured financings rather than sales under SFAS No. 140. We distributed to investors the securities that were issued by the securitization vehicles and therefore did not bear economic exposure to the underlying mortgage whole loans.
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A large portion of these assets are funded through secured funding markets or nonrecourse financing. We focus on funding these assets on a secured basis with long contractual maturities to reduce refinancing risk in periods of market stress.

See Note 3 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding the financial instruments we hold.

### ***Conservative Liability Structure***

We seek to structure our liabilities conservatively to reduce refinancing risk and the risk that we may be required to redeem or repurchase certain of our borrowings prior to their contractual maturity.

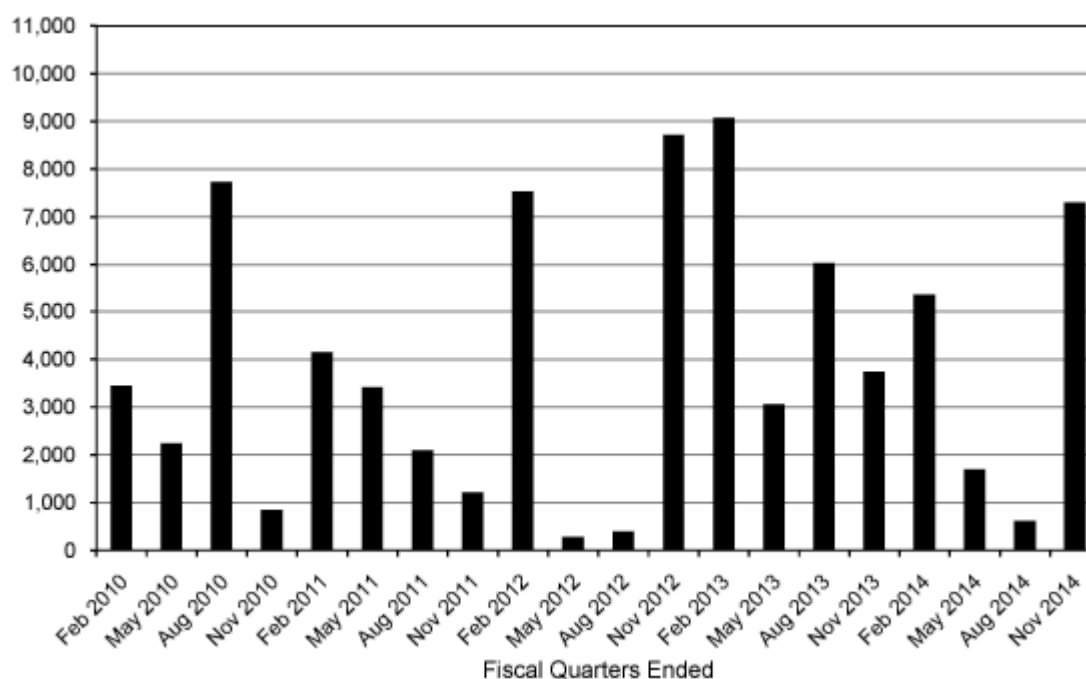
We fund a substantial portion of our inventory on a secured basis, which we believe provides Goldman Sachs with a more stable source of liquidity than unsecured financing, as it is less sensitive to changes in our credit due to the underlying collateral. However, we recognize that the terms or availability of secured funding, particularly overnight funding, can deteriorate rapidly in a difficult environment. To help mitigate this risk, we raise the majority of our funding for durations longer than overnight. We seek longer terms for secured funding collateralized by lower-quality assets, as we believe these funding transactions may pose greater refinancing risk. The weighted average life of our secured funding, excluding funding collateralized by highly liquid securities, such as U.S., French, German, United Kingdom and Japanese government bonds, and U.S. agency securities, exceeded 100 days as of November 2008.

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Our liquidity also depends to an important degree on the stability of our short-term unsecured financing base. Accordingly, we prefer the use of promissory notes (in which Goldman Sachs does not make a market) over commercial paper, which we may repurchase prior to maturity through the ordinary course of business as a market maker. As of November 2008 and November 2007, our unsecured short-term borrowings, including the current portion of unsecured long-term borrowings, were \$52.66 billion and \$71.56 billion, respectively. See Note 6 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for further information regarding our unsecured short-term borrowings.

We issue long-term borrowings as a source of total capital in order to meet our long-term financing requirements. The following table sets forth our quarterly unsecured long-term borrowings maturity profile through 2014:

**Unsecured Long-Term Borrowings Maturity Profile**  
(\$ in millions)



The weighted average maturity of our unsecured long-term borrowings as of November 2008 was approximately eight years. To mitigate refinancing risk, we seek to limit the principal amount of debt maturing on any one day or during any week or year. We swap a substantial portion of our long-term borrowings into U.S. dollar obligations with short-term floating interest rates in order to minimize our exposure to interest rates and foreign exchange movements.

We issue substantially all of our unsecured debt without provisions that would, based solely upon an adverse change in our credit ratings, financial ratios, earnings, cash flows or stock price, trigger a requirement for an early payment, collateral support, change in terms, acceleration of maturity or the creation of an additional financial obligation.

As of November 2008, our bank depository institution subsidiaries had \$27.64 billion in customer deposits, including \$19.15 billion of deposits from our bank sweep programs and \$8.49 billion of brokered certificates of deposit with a weighted average maturity of three years. In addition, we are pursuing a number of strategies to raise additional deposits as a source of funding for the firm. As of

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September 2008, GS Bank USA has access to funding through the Federal Reserve Bank discount window. While we do not rely on funding through the Federal Reserve Bank discount window in our liquidity modeling and stress testing, we maintain policies and procedures necessary to access this funding.

We seek to maintain broad and diversified funding sources globally for both secured and unsecured funding. We make extensive use of the repurchase agreement and securities lending markets, as well as other secured funding markets. In addition, we issue debt through syndicated U.S. registered offerings, U.S. registered and 144A medium-term note programs, offshore medium-term note offerings and other bond offerings, U.S. and non-U.S. commercial paper and promissory note issuances and other methods. We also arrange for letters of credit to be issued on our behalf.

We seek to distribute our funding products through our own sales force to a large, diverse global creditor base and we believe that our relationships with our creditors are critical to our liquidity. Our creditors include banks, governments, securities lenders, pension funds, insurance companies, mutual funds and individuals. We access funding in a variety of markets in the Americas, Europe and Asia. We have imposed various internal guidelines on creditor concentration, including the amount of our commercial paper and promissory notes that can be owned and letters of credit that can be issued by any single creditor or group of creditors.

In the latter half of 2008, we were unable to raise significant amounts of long-term unsecured debt in the public markets, other than as a result of the issuance of securities guaranteed by the FDIC under the TLGP. It is unclear when we will regain access to the public long-term unsecured debt markets on customary terms or whether any similar program will be available after the TLGP's scheduled June 2009 expiration. However, we continue to have access to short-term funding and to a number of sources of secured funding, both in the private markets and through various government and central bank sponsored initiatives.

Over the past year, a number of U.S. regulatory agencies have taken steps to enhance the liquidity support available to financial services companies such as Group Inc., GS&Co., GSI and GS Bank USA. Some of these steps include:

- The Federal Reserve Bank of New York established the Primary Dealer Credit Facility in March 2008 to provide overnight funding to primary dealers in exchange for a specified range of collateral. In September 2008, the eligible collateral was expanded to include all collateral eligible in tri-party repurchase arrangements with the major clearing banks, and the facility was made available to GSI. This facility is scheduled to expire on April 30, 2009.
- The Federal Reserve Board introduced a new Term Securities Lending Facility (TSLF) in March 2008, which extended the term for which the Federal Reserve Board will lend Treasury securities to primary dealers from overnight to 28 days and, in September 2008, expanded the types of assets that can be used as collateral under the TSLF to include all investment-grade debt securities (rather than just Treasury, agency and certain AAA-rated asset-backed securities). This facility is scheduled to expire on April 30, 2009.
- In October 2008, the Federal Reserve Board established the Commercial Paper Funding Facility (CPFF) to serve as a funding backstop to facilitate the issuance of term commercial paper by eligible issuers. Through the CPFF, the Federal Reserve Bank of New York will finance the purchase of unsecured and asset-backed highly rated, U.S. dollar-denominated, three-month commercial paper from eligible issuers through its primary dealers. The facility is scheduled to expire on April 30, 2009. Our available funding under the CPFF is approximately \$11 billion, of which a de minimis amount was utilized as of January 22, 2009.

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- The FDIC's TLGP, which was established in October 2008, provides a guarantee of certain newly issued senior unsecured debt issued by eligible entities, including Group Inc. and GS Bank USA, as well as funds over \$250,000 in non-interest-bearing transaction deposit accounts held by FDIC-insured banks (such as GS Bank USA). The debt guarantee is available, subject to limitations, for debt issued through June 30, 2009 and the deposit coverage lasts through December 31, 2009. We are able to have outstanding approximately \$35 billion of debt under the TLGP that is issued prior to June 30, 2009. As of November 2008 and January 22, 2009, we had outstanding \$4.18 billion of senior unsecured short-term borrowings and \$25.54 billion of senior unsecured debt (comprised of \$11.57 billion of short-term and \$13.97 billion of long-term), respectively, under the TLGP.

See “— Certain Risk Factors That May Affect Our Businesses” above, and “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for a discussion of factors that could impair our ability to access the capital markets.

**Subsidiary Funding Policies.** Substantially all of our unsecured funding is raised by our parent company, Group Inc. The parent company then lends the necessary funds to its subsidiaries, some of which are regulated, to meet their asset financing and capital requirements. In addition, the parent company provides its regulated subsidiaries with the necessary capital to meet their regulatory requirements. The benefits of this approach to subsidiary funding include enhanced control and greater flexibility to meet the funding requirements of our subsidiaries. Funding is also raised at the subsidiary level through secured funding and deposits.

Our intercompany funding policies are predicated on an assumption that, unless legally provided for, funds or securities are not freely available from a subsidiary to its parent company or other subsidiaries. In particular, many of our subsidiaries are subject to laws that authorize regulatory bodies to block or limit the flow of funds from those subsidiaries to Group Inc. Regulatory action of that kind could impede access to funds that Group Inc. needs to make payments on obligations, including debt obligations. As such, we assume that capital or other financing provided to our regulated subsidiaries is not available to our parent company or other subsidiaries until the maturity of such financing. In addition, we recognize that the Global Core Excess held in our regulated entities may not be available to our parent company or other subsidiaries and therefore may only be available to meet the potential liquidity requirements of those entities.

We also manage our liquidity risk by requiring senior and subordinated intercompany loans to have maturities equal to or shorter than the maturities of the aggregate borrowings of the parent company. This policy ensures that the subsidiaries' obligations to the parent company will generally mature in advance of the parent company's third-party borrowings. In addition, many of our subsidiaries and affiliates maintain unencumbered assets to cover their unsecured intercompany borrowings (other than subordinated debt) in order to mitigate parent company liquidity risk.

Group Inc. has provided substantial amounts of equity and subordinated indebtedness, directly or indirectly, to its regulated subsidiaries; for example, as of November 2008, Group Inc. had \$26.01 billion of such equity and subordinated indebtedness invested in GS&Co., its principal U.S. registered broker-dealer; \$22.06 billion invested in GSI, a regulated U.K. broker-dealer; \$2.48 billion invested in Goldman Sachs Execution & Clearing, L.P., a U.S. registered broker-dealer; \$3.79 billion invested in Goldman Sachs Japan Co., Ltd., a regulated Japanese broker-dealer; and \$17.32 billion invested in GS Bank USA, a regulated New York State-chartered bank. Group Inc. also had \$62.81 billion of unsubordinated loans to these entities as of November 2008, as well as significant amounts of capital invested in and loans to its other regulated subsidiaries.

## ***Crisis Planning***

In order to be prepared for a liquidity event, or a period of market stress, we base our liquidity risk management framework and our resulting funding and liquidity policies on conservative stress-scenario assumptions. Our planning incorporates several market-based and operational stress scenarios. We also periodically conduct liquidity crisis drills to test our lines of communication and backup funding procedures.

In addition, we maintain a liquidity crisis plan that specifies an approach for analyzing and responding to a liquidity-threatening event. The plan provides the framework to estimate the likely impact of a liquidity event on Goldman Sachs based on some of the risks identified above and outlines which and to what extent liquidity maintenance activities should be implemented based on the severity of the event.

## ***Credit Ratings***

We rely upon the short-term and long-term debt capital markets to fund a significant portion of our day-to-day operations. The cost and availability of debt financing is influenced by our credit ratings. Credit ratings are important when we are competing in certain markets and when we seek to engage in longer-term transactions, including OTC derivatives. We believe our credit ratings are primarily based on the credit rating agencies' assessment of our liquidity, market, credit and operational risk management practices, the level and variability of our earnings, our capital base, our franchise, reputation and management, our corporate governance and the external operating environment. See "— Certain Risk Factors That May Affect Our Businesses" above, and "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for a discussion of the risks associated with a reduction in our credit ratings.

On December 16, 2008, Moody's Investors Service affirmed Group Inc.'s Short-Term Debt rating and lowered Group Inc.'s ratings on Long-Term Debt (from Aa3 to A1), Subordinated Debt (from A1 to A2) and Preferred Stock (from A2 to A3), and retained its outlook of "negative." Also on December 16, 2008, Dominion Bond Rating Service Limited affirmed Group Inc.'s credit ratings but revised its outlook from "negative" to "under review with negative implications." On December 17, 2008, Rating and Investment Information, Inc. affirmed Group Inc.'s Short-Term Debt rating at a-1+, lowered Group Inc.'s Long-Term Debt ratings from AA to AA- and retained its outlook of "negative." On December 19, 2008, Standard & Poor's Ratings Services lowered Group Inc.'s ratings on Short-Term Debt (from A-1+ to A-1), Long-Term Debt (from AA- to A), Subordinated Debt (from A+ to A-) and Preferred Stock (from A to BBB) and retained its outlook of "negative." On January 23, 2009, Dominion Bond Rating Service Limited lowered Group Inc.'s ratings on Long-Term Debt (from AA (low) to A (high)), Subordinated Debt (from A (high) to A) and Preferred Stock (from A to A (low)).

The following table sets forth our unsecured credit ratings as of January 23, 2009:

	<u>Short-Term Debt</u>	<u>Long-Term Debt</u>	<u>Subordinated Debt</u>	<u>Preferred Stock</u>
Dominion Bond Rating Service Limited	R-1 (middle)	A (high)	A	A (low)
Fitch, Inc.	F1+	AA-	A+	A+
Moody's Investors Service	P-1	A1	A2	A3
Standard & Poor's Ratings Services	A-1	A	A-	BBB
Rating and Investment Information, Inc.	a-1+	AA-	Not Applicable	Not Applicable

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Based on our credit ratings as of November 2008, additional collateral or termination payments pursuant to bilateral agreements with certain counterparties of approximately \$1.11 billion and \$1.51 billion would have been required in the event of a one-notch and two-notch reduction, respectively, in our long-term credit ratings. Based on our credit ratings reflected in the above table, additional collateral or termination payments pursuant to bilateral agreements with certain counterparties of approximately \$897 million and \$2.14 billion would have been required in the event of a one-notch and two-notch reduction, respectively, in our long-term credit ratings as of December 26, 2008. In evaluating our liquidity requirements, we consider additional collateral or termination payments that would be required in the event of a two-notch reduction in our long-term credit ratings, as well as collateral that has not been called by counterparties, but is available to them.

### **Cash Flows**

As a global financial institution, our cash flows are complex and interrelated and bear little relation to our net earnings and net assets and, consequently, we believe that traditional cash flow analysis is less meaningful in evaluating our liquidity position than the excess liquidity and asset-liability management policies described above. Cash flow analysis may, however, be helpful in highlighting certain macro trends and strategic initiatives in our business.

**Year Ended November 2008.** Our cash and cash equivalents increased by \$5.46 billion to \$15.74 billion at the end of 2008. We raised \$9.80 billion in net cash from operating and financing activities, primarily from common and preferred stock issuances and deposits, partially offset by repayments of short-term borrowings. We used net cash of \$4.34 billion in our investing activities.

**Year Ended November 2007.** Our cash and cash equivalents increased by \$4.34 billion to \$10.28 billion at the end of 2007. We raised \$73.79 billion in net cash from financing and investing activities, primarily through the issuance of unsecured borrowings, partially offset by common stock repurchases. We used net cash of \$69.45 billion in our operating activities, primarily to capitalize on trading and investing opportunities for our clients and ourselves.

### **Operational Risk**

Operational risk relates to the risk of loss arising from shortcomings or failures in internal processes, people or systems, or from external events. Operational risk can arise from many factors ranging from routine processing errors to potentially costly incidents related to, for example, major systems failures. Operational risk may also cause reputational harm. Thus, efforts to identify, manage and mitigate operational risk must be equally sensitive to the risk of reputational damage as well as the risk of financial loss.

We manage operational risk through the application of long-standing, but continuously evolving, firmwide control standards which are supported by the training, supervision and development of our people; the active participation and commitment of senior management in a continuous process of identifying and mitigating key operational risks across Goldman Sachs; and a framework of strong and independent control departments that monitor operational risk on a daily basis. Together, these elements form a strong firmwide control culture that serves as the foundation of our efforts to minimize operational risk exposure.

Operational Risk Management & Analysis, a risk management function independent of our revenue-producing units, is responsible for developing and implementing a formalized framework to identify, measure, monitor, and report operational risks to support active risk management across Goldman Sachs. This framework, which evolves with the changing needs of our businesses and regulatory guidance, incorporates analysis of internal and external operational risk events, business environment and internal control factors, and scenario analysis. The framework also provides regular reporting of our operational risk exposures to our Board, risk committees and senior management. For a further discussion of operational risk see “— Certain Risk Factors That May Affect Our Businesses” above, and “— Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K.



## Recent Accounting Developments

**EITF Issue No. 06-11.** In June 2007, the Emerging Issues Task Force (EITF) reached consensus on Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." EITF Issue No. 06-11 requires that the tax benefit related to dividend equivalents paid on restricted stock units, which are expected to vest, be recorded as an increase to additional paid-in capital. We currently account for this tax benefit as a reduction to income tax expense. EITF Issue No. 06-11 is to be applied prospectively for tax benefits on dividends declared in fiscal years beginning after December 15, 2007. We do not expect the adoption of EITF Issue No. 06-11 to have a material effect on our financial condition, results of operations or cash flows.

**FASB Staff Position No. FAS 140-3.** In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions." FSP No. FAS 140-3 requires an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction under SFAS No. 140 unless certain criteria are met, including that the transferred asset must be readily obtainable in the marketplace. FSP No. FAS 140-3 is effective for fiscal years beginning after November 15, 2008, and is applicable to new transactions entered into after the date of adoption. Early adoption is prohibited. We do not expect adoption of FSP No. FAS 140-3 to have a material effect on our financial condition and cash flows. Adoption of FSP No. FAS 140-3 will have no effect on our results of operations.

**SFAS No. 161.** In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133." SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities, and is effective for financial statements issued for reporting periods beginning after November 15, 2008, with early application encouraged. Since SFAS No. 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS No. 161 will not affect our financial condition, results of operations or cash flows.

**FASB Staff Position No. EITF 03-6-1.** In June 2008, the FASB issued FSP No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." The FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in calculating earnings per share under the two-class method described in SFAS No. 128, "Earnings per Share." The FSP requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share. The FSP is effective for fiscal years beginning after December 15, 2008; earlier application is not permitted. We do not expect adoption of FSP No. EITF 03-6-1 to have a material effect on our results of operations or earnings per share.

**FASB Staff Position No. FAS 133-1 and FIN 45-4.** In September 2008, the FASB issued FSP No. FAS 133-1 and FIN 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161." FSP No. FAS 133-1 and FIN 45-4 requires enhanced disclosures about credit derivatives and guarantees and amends FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" to exclude credit derivative instruments accounted for at fair value under SFAS No. 133. The FSP is effective for financial statements issued for reporting periods ending after November 15, 2008. Since FSP No. FAS 133-1 and FIN 45-4 only requires additional disclosures concerning credit derivatives and guarantees, adoption of FSP No. FAS 133-1 and FIN 45-4 did not have an effect on our financial condition, results of operations or cash flows.



**FASB Staff Position No. FAS 157-3.** In October 2008, the FASB issued FSP No. FAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active.” FSP No. FAS 157-3 clarifies the application of SFAS No. 157 in an inactive market, without changing its existing principles. The FSP was effective immediately upon issuance. The adoption of FSP No. FAS 157-3 did not have an effect on our financial condition, results of operations or cash flows.

**SFAS No. 141(R).** In December 2007, the FASB issued a revision to SFAS No. 141, “Business Combinations.” SFAS No. 141(R) requires changes to the accounting for transaction costs, certain contingent assets and liabilities, and other balances in a business combination. In addition, in partial acquisitions, when control is obtained, the acquiring company must measure and record all of the target’s assets and liabilities, including goodwill, at fair value as if the entire target company had been acquired. We will apply the provisions of SFAS No. 141(R) to business combinations occurring after December 26, 2008. Adoption of SFAS No. 141(R) will not affect our financial condition, results of operations or cash flows, but may have an effect on accounting for future business combinations.

**SFAS No. 160.** In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51.” SFAS No. 160 requires that ownership interests in consolidated subsidiaries held by parties other than the parent (noncontrolling interests) be accounted for and presented as equity, rather than as a liability or mezzanine equity. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008, but the presentation and disclosure requirements are to be applied retrospectively. We do not expect adoption of the statement to have a material effect on our financial condition, results of operations or cash flows.

**FASB Staff Position No. FAS 140-4 and FIN 46(R)-8.** In December 2008, the FASB issued FSP No. FAS 140-4 and FIN 46(R)-8, “Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities.” FSP No. FAS 140-4 and FIN 46(R)-8 requires enhanced disclosures about transfers of financial assets and interests in variable interest entities. The FSP is effective for interim and annual periods ending after December 15, 2008. Since the FSP requires only additional disclosures concerning transfers of financial assets and interests in variable interest entities, adoption of the FSP will not affect our financial condition, results of operations or cash flows.

**EITF Issue No. 07-5.** In June 2008, the EITF reached consensus on Issue No. 07-5, “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock.” EITF Issue No. 07-5 provides guidance about whether an instrument (such as our outstanding common stock warrants) should be classified as equity and not marked to market for accounting purposes. EITF Issue No. 07-5 is effective for fiscal years beginning after December 15, 2008. Adoption of EITF Issue No. 07-5 will not affect our financial condition, results of operations or cash flows.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Quantitative and qualitative disclosure about market risk is set forth under “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Management” in Part II, Item 7 of our Annual Report on Form 10-K.

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## **Management's Report on Internal Control over Financial Reporting**

Management of The Goldman Sachs Group, Inc., together with its consolidated subsidiaries (the firm), is responsible for establishing and maintaining adequate internal control over financial reporting. The firm's internal control over financial reporting is a process designed under the supervision of the firm's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the firm's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

As of the end of the firm's 2008 fiscal year, management conducted an assessment of the effectiveness of the firm's internal control over financial reporting based on the framework established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the firm's internal control over financial reporting as of November 28, 2008 was effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the firm; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the firm's assets that could have a material effect on our financial statements.

The firm's internal control over financial reporting as of November 28, 2008 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing on page 130, which expresses an unqualified opinion on the effectiveness of the firm's internal control over financial reporting as of November 28, 2008.

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and the Shareholders of  
The Goldman Sachs Group, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of The Goldman Sachs Group, Inc. and its subsidiaries (the Company) at November 28, 2008 and November 30, 2007, and the results of its operations and its cash flows for each of the three fiscal years in the period ended November 28, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of November 28, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing on page 129. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2 to the consolidated financial statements, as of the beginning of 2007 the Company adopted SFAS No. 157, "Fair Value Measurements" and SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities."

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP

New York, New York  
January 22, 2009

**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF EARNINGS**

	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in millions, except per share amounts)		
<b>Revenues</b>			
Investment banking	\$ 5,179	\$ 7,555	\$ 5,613
Trading and principal investments	8,095	29,714	24,027
Asset management and securities services	4,672	4,731	4,527
Interest income	<u>35,633</u>	<u>45,968</u>	<u>35,186</u>
Total revenues	53,579	87,968	69,353
Interest expense	<u>31,357</u>	<u>41,981</u>	<u>31,688</u>
Revenues, net of interest expense	22,222	45,987	37,665
<b>Operating expenses</b>			
Compensation and benefits	10,934	20,190	16,457
Brokerage, clearing, exchange and distribution fees	2,998	2,758	1,985
Market development	485	601	492
Communications and technology	759	665	544
Depreciation and amortization	1,022	624	521
Amortization of identifiable intangible assets	240	195	173
Occupancy	960	975	850
Professional fees	779	714	545
Other expenses	<u>1,709</u>	<u>1,661</u>	<u>1,538</u>
Total non-compensation expenses	<u>8,952</u>	<u>8,193</u>	<u>6,648</u>
Total operating expenses	<u>19,886</u>	<u>28,383</u>	<u>23,105</u>
Pre-tax earnings	2,336	17,604	14,560
Provision for taxes	<u>14</u>	<u>6,005</u>	<u>5,023</u>
Net earnings	2,322	11,599	9,537
Preferred stock dividends	<u>281</u>	<u>192</u>	<u>139</u>
Net earnings applicable to common shareholders	<u>\$ 2,041</u>	<u>\$ 11,407</u>	<u>\$ 9,398</u>
<b>Earnings per common share</b>			
Basic	\$ 4.67	\$ 26.34	\$ 20.93
Diluted	4.47	24.73	19.69
<b>Average common shares outstanding</b>			
Basic	437.0	433.0	449.0
Diluted	456.2	461.2	477.4

The accompanying notes are an integral part of these consolidated financial statements.

**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

	<b>As of November</b>	
	<b>2008</b>	<b>2007</b>
	(in millions, except share and per share amounts)	
<b>Assets</b>		
Cash and cash equivalents	\$ 15,740	\$ 10,282
Cash and securities segregated for regulatory and other purposes (includes \$78,830 and \$94,018 at fair value as of November 2008 and November 2007, respectively)	106,664	119,939
Collateralized agreements:		
Securities purchased under agreements to resell, at fair value, and federal funds sold (includes \$116,671 and \$85,717 at fair value as of November 2008 and November 2007, respectively)	122,021	87,317
Securities borrowed (includes \$59,810 and \$83,277 at fair value as of November 2008 and November 2007, respectively)	180,795	277,413
Receivables from brokers, dealers and clearing organizations	25,899	19,078
Receivables from customers and counterparties (includes \$1,598 and \$1,950 at fair value as of November 2008 and November 2007, respectively)	64,665	129,105
Trading assets, at fair value (includes \$26,313 and \$46,138 pledged as collateral as of November 2008 and November 2007, respectively)	338,325	452,595
Other assets	30,438	24,067
Total assets	<u>\$884,547</u>	<u>\$ 1,119,796</u>
<b>Liabilities and shareholders' equity</b>		
Deposits (includes \$4,224 and \$463 at fair value as of November 2008 and November 2007, respectively)	\$ 27,643	\$ 15,370
Collateralized financings:		
Securities sold under agreements to repurchase, at fair value	62,883	159,178
Securities loaned (includes \$7,872 and \$5,449 at fair value as of November 2008 and November 2007, respectively)	17,060	28,624
Other secured financings (includes \$20,249 and \$33,581 at fair value as of November 2008 and November 2007, respectively)	38,683	65,710
Payables to brokers, dealers and clearing organizations	8,585	8,335
Payables to customers and counterparties	245,258	310,118
Trading liabilities, at fair value	175,972	215,023
Unsecured short-term borrowings, including the current portion of unsecured long-term borrowings (includes \$23,075 and \$48,331 at fair value as of November 2008 and November 2007, respectively)	52,658	71,557
Unsecured long-term borrowings (includes \$17,446 and \$15,928 at fair value as of November 2008 and November 2007, respectively)	168,220	164,174
Other liabilities and accrued expenses (includes \$978 at fair value as of November 2008)	23,216	38,907
Total liabilities	820,178	1,076,996
<b>Commitments, contingencies and guarantees</b>		
<b>Shareholders' equity</b>		
Preferred stock, par value \$0.01 per share; aggregate liquidation preference of \$18,100 and \$3,100 as of November 2008 and November 2007, respectively	16,471	3,100
Common stock, par value \$0.01 per share; 4,000,000,000 shares authorized, 680,953,836 and 618,707,032 shares issued as of November 2008 and November 2007, respectively, and 442,537,317 and 390,682,013 shares outstanding as of November 2008 and November 2007, respectively	7	6
Restricted stock units and employee stock options	9,284	9,302
Nonvoting common stock, par value \$0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding	—	—
Additional paid-in capital	31,071	22,027
Retained earnings	39,913	38,642
Accumulated other comprehensive income/(loss)	(202)	(118)
Common stock held in treasury, at cost, par value \$0.01 per share; 238,416,519 and 228,025,019 shares as of November 2008 and November 2007, respectively	(32,175)	(30,159)
Total shareholders' equity	<u>64,369</u>	<u>42,800</u>
Total liabilities and shareholders' equity	<u>\$884,547</u>	<u>\$ 1,119,796</u>

The accompanying notes are an integral part of these consolidated financial statements.

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**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in millions, except per share amounts)		
<b>Preferred stock</b>			
Balance, beginning of year	\$ 3,100	\$ 3,100	\$ 1,750
Issued	13,367	—	1,350
Preferred stock accretion	4	—	—
Balance, end of year	16,471	3,100	3,100
<b>Common stock, par value \$0.01 per share</b>			
Balance, beginning of year	6	6	6
Issued	1	—	—
Balance, end of year	7	6	6
<b>Restricted stock units and employee stock options</b>			
Balance, beginning of year	9,302	6,290	3,415
Issuance and amortization of restricted stock units and employee stock options	2,254	4,684	3,787
Delivery of common stock underlying restricted stock units	(1,995)	(1,548)	(781)
Forfeiture of restricted stock units and employee stock options	(274)	(113)	(129)
Exercise of employee stock options	(3)	(11)	(2)
Balance, end of year	9,284	9,302	6,290
<b>Additional paid-in capital</b>			
Balance, beginning of year	22,027	19,731	17,159
Issuance of common stock warrants	1,633	—	—
Issuance of common stock, including the delivery of common stock underlying restricted stock units and proceeds from the exercise of employee stock options	8,081	2,338	2,432
Cancellation of restricted stock units in satisfaction of withholding tax requirements	(1,314)	(929)	(375)
Stock purchase contract fee related to automatic preferred enhanced capital securities	—	(20)	—
Preferred and common stock issuance costs	(1)	—	(1)
Excess net tax benefit related to share-based compensation	645	908	653
Cash settlement of share-based compensation	—	(1)	(137)
Balance, end of year	31,071	22,027	19,731
<b>Retained earnings</b>			
Balance, beginning of year, as previously reported	38,642	27,868	19,085
Cumulative effect of adjustment from adoption of FIN 48	(201)	—	—
Cumulative effect of adjustment from adoption of SFAS No. 157, net of tax	—	51	—
Cumulative effect of adjustment from adoption of SFAS No. 159, net of tax	—	(45)	—
Balance, beginning of year, after cumulative effect of adjustments	38,441	27,874	19,085
Net earnings	2,322	11,599	9,537
Dividends and dividend equivalents declared on common stock and restricted stock units	(642)	(639)	(615)
Dividends declared on preferred stock	(204)	(192)	(139)
Preferred stock accretion	(4)	—	—
Balance, end of year	39,913	38,642	27,868
<b>Accumulated other comprehensive income/(loss)</b>			
Balance, beginning of year	(118)	21	—
Adjustment from adoption of SFAS No. 158, net of tax	—	(194)	—
Currency translation adjustment, net of tax	(98)	39	45
Pension and postretirement liability adjustment, net of tax	69	38	(27)
Net gains/(losses) on cash flow hedges, net of tax	—	(2)	(7)
Net unrealized gains/(losses) on available-for-sale securities, net of tax	(55)	(12)	10
Reclassification to retained earnings from adoption of SFAS No. 159, net of tax	—	(8)	—
Balance, end of year	(202)	(118)	21
<b>Common stock held in treasury, at cost</b>			
Balance, beginning of year	(30,159)	(21,230)	(13,413)
Repurchased	(2,037)	(8,956)	(7,817)
Reissued	21	27	—
Balance, end of year	(32,175)	(30,159)	(21,230)
<b>Total shareholders' equity</b>	<b>\$ 64,369</b>	<b>\$ 42,800</b>	<b>\$ 35,786</b>

The accompanying notes are an integral part of these consolidated financial statements.



# THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended November		
	2008	2007	2006
	(in millions)		
<b>Cash flows from operating activities</b>			
Net earnings	\$ 2,322	\$ 11,599	\$ 9,537
Non-cash items included in net earnings			
Depreciation and amortization	1,385	916	749
Amortization of identifiable intangible assets	240	251	246
Deferred income taxes	(1,763)	129	(1,505)
Share-based compensation	1,611	4,465	3,654
Changes in operating assets and liabilities			
Cash and securities segregated for regulatory and other purposes	12,995	(39,079)	(21,044)
Net receivables from brokers, dealers and clearing organizations	(6,587)	(3,811)	(1,794)
Net payables to customers and counterparties	(50)	53,857	9,823
Securities borrowed, net of securities loaned	85,054	(51,655)	(28,666)
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell and federal funds sold	(130,999)	6,845	5,825
Trading assets, at fair value	97,723	(118,864)	(48,479)
Trading liabilities, at fair value	(39,051)	57,938	6,384
Other, net	(20,986)	7,962	12,823
Net cash provided by/(used for) operating activities	1,894	(69,447)	(52,447)
<b>Cash flows from investing activities</b>			
Purchase of property, leasehold improvements and equipment	(2,027)	(2,130)	(1,744)
Proceeds from sales of property, leasehold improvements and equipment	121	93	69
Business acquisitions, net of cash acquired	(2,613)	(1,900)	(1,661)
Proceeds from sales of investments	624	4,294	2,114
Purchase of available-for-sale securities	(3,851)	(872)	(12,922)
Proceeds from sales of available-for-sale securities	3,409	911	4,396
Net cash provided by/(used for) investing activities	(4,337)	396	(9,748)
<b>Cash flows from financing activities</b>			
Unsecured short-term borrowings, net	(19,295)	12,262	(4,031)
Other secured financings (short-term), net	(8,727)	2,780	16,856
Proceeds from issuance of other secured financings (long-term)	12,509	21,703	14,451
Repayment of other secured financings (long-term), including the current portion	(20,653)	(7,355)	(7,420)
Proceeds from issuance of unsecured long-term borrowings	37,758	57,516	48,839
Repayment of unsecured long-term borrowings, including the current portion	(25,579)	(14,823)	(13,510)
Derivative contracts with a financing element, net	781	4,814	3,494
Deposits, net	12,273	4,673	10,697
Common stock repurchased	(2,034)	(8,956)	(7,817)
Dividends and dividend equivalents paid on common stock, preferred stock and restricted stock units	(850)	(831)	(754)
Proceeds from issuance of common stock	6,105	791	1,613
Proceeds from issuance of preferred stock, net of issuance costs	13,366	—	1,349
Proceeds from issuance of common stock warrants	1,633	—	—
Excess tax benefit related to share-based compensation	614	817	464
Cash settlement of share-based compensation	—	(1)	(137)
Net cash provided by financing activities	7,901	73,390	64,094
Net increase in cash and cash equivalents	5,458	4,339	1,899
Cash and cash equivalents, beginning of year	10,282	5,943	4,044
Cash and cash equivalents, end of year	\$ 15,740	\$ 10,282	\$ 5,943

### SUPPLEMENTAL DISCLOSURES:

Cash payments for interest, net of capitalized interest, were \$32.37 billion, \$40.74 billion and \$30.98 billion for the years ended November 2008, November 2007 and November 2006, respectively.

Cash payments for income taxes, net of refunds, were \$3.47 billion, \$5.78 billion and \$4.56 billion for the years ended November 2008, November 2007 and November 2006, respectively.

### Non-cash activities:

The firm assumed \$790 million, \$409 million and \$498 million of debt in connection with business acquisitions for the years ended November 2008, November 2007 and November 2006, respectively.

The accompanying notes are an integral part of these consolidated financial statements.



**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Year Ended November</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
		(in millions)	
Net earnings	\$2,322	\$11,599	\$9,537
Currency translation adjustment, net of tax	(98)	39	45
Pension and postretirement liability adjustment, net of tax	69	38	(27)
Net gains/(losses) on cash flow hedges, net of tax	—	(2)	(7)
Net unrealized gains/(losses) on available-for-sale securities, net of tax	<u>(55)</u>	<u>(12)</u>	<u>10</u>
Comprehensive income	<u>\$2,238</u>	<u>\$11,662</u>	<u>\$9,558</u>

The accompanying notes are an integral part of these consolidated financial statements.

## THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Note 1. Description of Business

The Goldman Sachs Group, Inc. (Group Inc.), a Delaware corporation, is a bank holding company and, together with its consolidated subsidiaries (collectively, the firm), a leading global investment banking, securities and investment management firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

The firm's activities are divided into three segments:

- **Investment Banking.** The firm provides a broad range of investment banking services to a diverse group of corporations, financial institutions, investment funds, governments and individuals.
- **Trading and Principal Investments.** The firm facilitates client transactions with a diverse group of corporations, financial institutions, investment funds, governments and individuals and takes proprietary positions through market making in, trading of and investing in fixed income and equity products, currencies, commodities and derivatives on these products. In addition, the firm engages in market-making and specialist activities on equities and options exchanges, and the firm clears client transactions on major stock, options and futures exchanges worldwide. In connection with the firm's merchant banking and other investing activities, the firm makes principal investments directly and through funds that the firm raises and manages.
- **Asset Management and Securities Services.** The firm provides investment advisory and financial planning services and offers investment products (primarily through separately managed accounts and commingled vehicles, such as mutual funds and private investment funds) across all major asset classes to a diverse group of institutions and individuals worldwide and provides prime brokerage services, financing services and securities lending services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and to high-net-worth individuals worldwide.

#### Note 2. Significant Accounting Policies

##### ***Basis of Presentation***

These consolidated financial statements include the accounts of Group Inc. and all other entities in which the firm has a controlling financial interest. All material intercompany transactions and balances have been eliminated.

The firm determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity, a variable interest entity (VIE) or a qualifying special-purpose entity (QSPE) under generally accepted accounting principles.

- **Voting Interest Entities.** Voting interest entities are entities in which (i) the total equity investment at risk is sufficient to enable the entity to finance its activities independently and (ii) the equity holders have the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. Voting interest entities are consolidated in accordance with Accounting Research Bulletin No. 51, "Consolidated Financial Statements," as amended. The usual condition for a controlling financial interest in an entity is ownership of a majority voting interest. Accordingly, the firm consolidates voting interest entities in which it has a majority voting interest.
- **Variable Interest Entities.** VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when an enterprise has a variable interest, or a combination of variable interests, that will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. The

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**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. In accordance with Financial Accounting Standards Board (FASB) Interpretation (FIN) 46-R, "Consolidation of Variable Interest Entities," the firm consolidates VIEs for which it is the primary beneficiary. The firm determines whether it is the primary beneficiary of a VIE by first performing a qualitative analysis of the VIE's expected losses and expected residual returns. This analysis includes a review of, among other factors, the VIE's capital structure, contractual terms, which interests create or absorb variability, related party relationships and the design of the VIE. Where qualitative analysis is not conclusive, the firm performs a quantitative analysis. For purposes of allocating a VIE's expected losses and expected residual returns to its variable interest holders, the firm utilizes the "top down" method. Under that method, the firm calculates its share of the VIE's expected losses and expected residual returns using the specific cash flows that would be allocated to it, based on contractual arrangements and/or the firm's position in the capital structure of the VIE, under various probability-weighted scenarios. The firm reassesses its initial evaluation of an entity as a VIE and its initial determination of whether the firm is the primary beneficiary of a VIE upon the occurrence of certain reconsideration events as defined in FIN 46-R.

- **QSPEs.** QSPEs are passive entities that are commonly used in mortgage and other securitization transactions. Statement of Financial Accounting Standards (SFAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," sets forth the criteria an entity must satisfy to be a QSPE. These criteria include the types of assets a QSPE may hold, limits on asset sales, the use of derivatives and financial guarantees, and the level of discretion a servicer may exercise in attempting to collect receivables. These criteria may require management to make judgments about complex matters, such as whether a derivative is considered passive and the level of discretion a servicer may exercise, including, for example, determining when default is reasonably foreseeable. In accordance with SFAS No. 140 and FIN 46-R, the firm does not consolidate QSPEs.
- **Equity-Method Investments.** When the firm does not have a controlling financial interest in an entity but exerts significant influence over the entity's operating and financial policies (generally defined as owning a voting interest of 20% to 50%) and has an investment in common stock or in-substance common stock, the firm accounts for its investment either in accordance with Accounting Principles Board Opinion (APB) No. 18, "The Equity Method of Accounting for Investments in Common Stock" or at fair value in accordance with SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." In general, the firm accounts for investments acquired subsequent to the adoption of SFAS No. 159 at fair value. In certain cases, the firm may apply the equity method of accounting to new investments that are strategic in nature or closely related to the firm's principal business activities, where the firm has a significant degree of involvement in the cash flows or operations of the investee, or where cost-benefit considerations are less significant. See "— Revenue Recognition — Other Financial Assets and Financial Liabilities at Fair Value" below for a discussion of the firm's application of SFAS No. 159.
- **Other.** If the firm does not consolidate an entity or apply the equity method of accounting, the firm accounts for its investment at fair value. The firm also has formed numerous nonconsolidated investment funds with third-party investors that are typically organized as limited partnerships. The firm acts as general partner for these funds and generally does not hold a majority of the economic interests in these funds. The firm has generally provided the third-party investors with rights to terminate the funds or to remove the firm as the general partner. As a result, the firm does not consolidate these funds. These fund investments are included in "Trading assets, at fair value" in the consolidated statements of financial condition.

**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Unless otherwise stated herein, all references to 2008, 2007 and 2006 refer to the firm's fiscal years ended, or the dates, as the context requires, November 28, 2008, November 30, 2007 and November 24, 2006, respectively. Certain reclassifications have been made to previously reported amounts to conform to the current presentation.

***Use of Estimates***

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles that require management to make certain estimates and assumptions. The most important of these estimates and assumptions relate to fair value measurements, the accounting for goodwill and identifiable intangible assets and the provision for potential losses that may arise from litigation and regulatory proceedings and tax audits. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

***Revenue Recognition***

**Investment Banking.** Underwriting revenues and fees from mergers and acquisitions and other financial advisory assignments are recognized in the consolidated statements of earnings when the services related to the underlying transaction are completed under the terms of the engagement. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded. Underwriting revenues are presented net of related expenses. Expenses associated with financial advisory transactions are recorded as non-compensation expenses, net of client reimbursements.

**Trading Assets and Trading Liabilities.** Substantially all trading assets and trading liabilities are reflected in the consolidated statements of financial condition at fair value, pursuant principally to:

- SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities;"
- specialized industry accounting for broker-dealers and investment companies;
- SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities;" or
- the fair value option under either SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments — an amendment of FASB Statements No. 133 and 140," or SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," (i.e., the fair value option).

Related unrealized gains or losses are generally recognized in "Trading and principal investments" in the consolidated statements of earnings.

Upon becoming a bank holding company in September 2008, the firm could no longer apply specialized broker-dealer industry accounting to those subsidiaries not regulated as broker-dealers. Therefore, within the firm's non-broker-dealer subsidiaries, the firm designated as held for trading those instruments within the scope of SFAS No. 115 (i.e., debt securities and marketable equity securities), and elected the fair value option for other cash instruments (specifically loans, loan commitments and certain private equity and restricted public equity securities) which the firm historically had carried at fair value. These fair value elections were in addition to previous elections made for certain corporate loans, loan commitments and certificates of deposit issued by Goldman Sachs Bank USA (GS Bank USA). There was no impact on earnings from these initial elections because all of these instruments were already recorded at fair value in "Trading assets, at fair value" or "Trading liabilities, at fair value" in the consolidated statements of financial condition prior to Group Inc. becoming a bank holding company.

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**THE GOLDMAN SACHS GROUP, INC. and SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Other Financial Assets and Financial Liabilities at Fair Value.** In addition to “Trading assets, at fair value” and “Trading liabilities, at fair value,” the firm has elected to account for certain of its other financial assets and financial liabilities at fair value under the fair value option. The primary reasons for electing the fair value option are to reflect economic events in earnings on a timely basis, to mitigate volatility in earnings from using different measurement attributes and to address simplification and cost-benefit considerations.

Such financial assets and financial liabilities accounted for at fair value include:

- certain unsecured short-term borrowings, consisting of all promissory notes and commercial paper and certain hybrid financial instruments;
- certain other secured financings, primarily transfers accounted for as financings rather than sales under SFAS No. 140, debt raised through the firm’s William Street program and certain other nonrecourse financings;
- certain unsecured long-term borrowings, including prepaid physical commodity transactions;
- resale and repurchase agreements;
- securities borrowed and loaned within Trading and Principal Investments, consisting of the firm’s matched book and certain firm financing activities;
- certain corporate loans, loan commitments and certificates of deposit issued by GS Bank USA as well as securities held by GS Bank USA;
- receivables from customers and counterparties arising from transfers accounted for as secured loans rather than purchases under SFAS No. 140;
- certain insurance and reinsurance contracts; and
- in general, investments acquired after the adoption of SFAS No. 159 where the firm has significant influence over the investee and would otherwise apply the equity method of accounting.

**Fair Value Measurements.** The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs.

The firm adopted SFAS No. 157, “Fair Value Measurements,” as of the beginning of 2007. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Basis of Fair Value Measurement