Operator

Good morning. My name is Dennis, and I will be your conference facilitator today. I would like to welcome everyone to The Goldman Sachs Second Quarter 2011 Earnings Conference Call. [Operator Instructions] Also, this call is being recorded today, Tuesday, July 19, 2011. Thank you. Mr. Holmes, you may begin your conference.

Dane Holmes

Good morning. This is Dane Holmes, Director of Investor Relations at Goldman Sachs. Welcome to our Second Quarter Earnings Conference Call. Today's call may include forward-looking statements. These statements represent the firm's belief regarding future events that by their nature are uncertain and outside of the firm's control. The firm's actual results and financial condition may differ, possibly materially, from what is indicated in these -- in those forward-looking statements.

For a discussion of some of the risks and factors that could affect the firm's future results, please see the description of risk factors in our current annual report on Form 10-K for our fiscal year ended December 2010.

I would also direct you to read the forward-looking disclaimers in our quarterly earnings release, particularly as it relates to our Investment Banking transaction backlog, capital ratios, risk-weighted assets and global core excess. And you should also read the information on the calculation of non-GAAP financial measures that is posted on the Investor Relations portion of our website, www.gs.com.

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Our Chief Financial Officer, David Viniar, will now review the firm's results. David?

David A. Viniar

Thanks, Dane. I'd like to thank all of you for listening today. I'll give an overview of our second quarter results and then take your questions.

Net revenues in the second quarter were $7.3 billion, and net earnings were $1.1 billion. Earnings per diluted share were $1.85, and our annualized return on common equity was 6.1%.

Year-to-date, excluding the impact of a $1.6 billion preferred dividend associated with our repayment of the Berkshire Hathaway preferred stock in the first quarter, our annualized return on common equity was 10.2%. Including the impact, our annualized return on common equity was 8%.

The second quarter was dominated by concerns surrounding the state of the global economy. These concerns emanated from a variety of regions around the world including Europe, the United States and China. While many of these concerns have been around for quite some time, the further deterioration in economic data coupled with the passage of time without resolution of the significant number of political issues has led to heightened concerns among market participants.

Sovereign risk in a number of smaller European member states increased with a particular focus on development increase. Concerns remain for other countries within Europe and the potential negative economic impact on financial institutions with credit exposure to these sovereigns.

Within the U.S., concerns have centered on the political debate on the raising the debt ceiling, a growing budget deficit, stubbornly high unemployment and potential further pressure on U.S. housing prices. Finally, there has also been greater focus on China given the important role it plays in the broader global economy.

The complexities surrounding the interplay of these various economic considerations has created tremendous uncertainty about the state of the world's economy and, among other things, has resulted in limited conviction among market participants.

As a result of this uncertainty, many of our investing clients have significantly reduced their risk appetite, and thus, activity levels generally declined. Despite these market uncertainties, we remain focused on serving the needs of our leading global client base.

Within Investment Banking, we continue to focus on providing our clients with world-class strategic advice and superior financing execution, which is reflected in our Investment Banking league table standards.

Year-to-date, we ranked first in announced M&A globally. We're also ranked first in equity and equity-related common stock offerings and IPOs global year-to-date.

We understand that our clients value consistent high-quality service and excellent execution, effectively meeting their needs for advice, financing, risk capital and liquidity, as well as asset management solutions essential to our long-term performance.

In the context of more difficult economic and financial conditions, the firm launched an internal initiative to identify areas where we can operate more efficiently. Thus far, we've targeted approximately $1.2 billion in run rate compensation and non-compensation reductions. We're in the process of implementing the cost reduction efforts and expect to complete them before year end.

I'll now review each of our businesses. Investment Banking produced second quarter net revenues of $1.4 billion, up 14% from first quarter results. Second quarter advisory revenues were $637 million, up 78% from the first quarter, reflecting a number of significant deal closings.

We advised on a number of important transactions that were announced during the quarter, including Johnson & Johnson's $21.3 billion acquisition of Synthes, Skype's $8.5 billion sale to Microsoft and Diversity's $4.3 billion sale to Sealed Air Corporation.

We're also the adviser on a number of significant closed transactions, including Pride International's $8.7 billion merger with ESCO, Beckman-Coulter's $6.8 billion sales to Danaher and Equinox Minerals' $7.7 billion sales to Barrick Gold.

Second quarter underwriting net revenues were $811 million, down 11% sequentially. Equity underwriting revenues of $378 million were down 11% from the first quarter, reflecting more challenging equity markets. Debt underwriting revenues decreased 11% to $433 million, reflecting lower investing grade and CMBS issuance volume, partially offset by strong leveraged finance activity.

During the second quarter, we participated in many noteworthy underwriting transactions, including PRADA's $2.5 billion IPO, Shanghai Pharmaceuticals' $2.1 billion IPO, and Wal-Mart's $5 billion long-term debt offering.

Our Investment Banking backlog was unchanged compared with the end of the first quarter.

Turning to Institutional Client Services, which is comprised of FICC and equities client execution, commissions and fees and security services, net revenues of $3.5 billion, were down 47% from the first quarter as continued macro concerns created more challenging market and operating conditions.

The effect of these macro concerns was more pronounced within our Asian and European FICC franchises, which have historically been significant contributors to the global franchise. Further, during the quarter, we were not as effective at navigating inter-quarter swing to the market prices and liquidity that we have been historically.

Consequently, we generated lower revenues from managing client-originated market-making inventory, particularly in our largely U.S.-based mortgages business and our global commodities and credit businesses.

In this environment, we were particularly prudent in the management of our market risk. This is highlighted by the fact that VaR in the second quarter was in its lowest quarterly level since the third quarter of 2006.

FICC Client Execution net revenues were $1.6 billion in the second quarter, down significantly from the first quarter, as every major business generated lower but positive revenues.

Our commodities business was negatively impacted by asset price fluctuations. Credit experienced the more challenging environment for hedging and inventory management. Our mortgages results reflected the negative impact of asset price decline, reduced market liquidity, and greater divergence between our cash positions and corresponding hedges, particularly in non-agency products. Interest rates and FX were also down but to a lesser extent.

In equities, which includes the equities client execution, commissions and fees and securities services, net revenues for the second quarter were $1.9 billion, down 17% sequentially.

Equities client execution revenues were down 36% to $623 million, reflecting lower net revenues within our cash and derivatives businesses as declining volumes and lower volatility impacted results.

Commissions and Fees were $861 million, down 11% from the first quarter on lower market volumes. Securities services net revenues of $432 million were 16% higher sequentially due to the seasonally stronger client activity.

Turning to risk. Average daily value of risk in the second quarter was $101 million, down 11% relative to the first quarter. Our value of risk remains at levels we have not experienced in a number of years.

Now I'll review Investing & Lending, which produced net revenue of $1 billion in the second quarter. The firm's Investing & Lending activities across various asset classes, primarily including debt securities and loan and equity securities, are included in this segment. These activities include both direct investing and investing through funds, as well as lending activities.

Our investment in ICBC produced a $176 million loss in the quarter. Other equity investments generated net revenues of $686 million across our portfolio of funded and direct investments.

Net revenues from debt securities and loans were $200 million, principally from interest income. Other revenues of $334 million were primarily driven by operating revenues from our consolidated investment entities.

In Investment Management, we reported second quarter net revenues of $1.3 billion, consistent with first quarter results. Management and other fees were 3% higher sequentially at $1.1 billion.

During the second quarter, assets under management increased $4 billion to $844 billion due to market appreciation in fixed income assets.

Turning to expenses, compensation and benefits expense, which includes salaries, bonuses, amortization of prior year equity awards, and other items such as payroll taxes and benefits, has accrued at a compensation-to-net-revenue ratio of 44% for the second quarter of 2011, a ratio consistent with the compensation accrual in the first quarter.

Second quarter non-compensation expenses were $2.5 billion, 6% lower than the first quarter, which included impairment charges of approximately $220 million related to assets classified as held for sale, primarily related to Litton Loan Servicing.

Adjusting for the $220 million impairment charge and provisions for litigation, non-compensation expenses in the second quarter of 2011 were essentially unchanged.

Total staff at the end of the second quarter is approximately 35,500, relatively unchanged from the end of the first quarter. Our effective tax rate was 32.6% for the second quarter.

As a management team, while we were disappointed in the performance of certain businesses this quarter, we're committed to creating long-term shareholder value. We believe that the core drivers of long-term value continue to be the strength of our global client franchise and our employees' tireless commitment to serving that franchise.

While the current environment presents a number of challenges, we continue to invest in expanding our global platform. Our effort to drive greater efficiencies within our operations are an important component supporting this growth plan.

We remain focused on generating superior returns for our shareholders. During the quarter, we repurchased 10.8 million shares of common stock for a total cost of $1.5 billion. Furthermore, our Board of Directors has authorized a 75 million share increase in our share repurchase program, bringing our total authorization to approximately 91 million shares.

In this ongoing challenging environment, we'll continue to balance near-term uncertainties with longer-term strategic goals. We will balance holding more capital and liquidity to protect against the current macro uncertainties with our commitment to providing strong relative return to our shareholders.

We'll invest for growth in attractive regions and businesses and reduce our commitment to businesses experiencing lower client demand. This adaptability is at the heart of our culture.

While the outlook remains uncertain, we'll continue to respond accordingly with the goal of positioning the firm to best serve our clients and shareholders.

With that, I'd like to thank you again for listening today, and I'm now happy to take your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line Glenn Schorr with Nomura.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

So if we could talk FICC for a little bit, I think that's where some of the focus is going to obviously come. And if you can give us a little more color towards kind of breaking down what is just bad positioning, bad trading quarter, weak environment, versus is there something bigger going on that's impacting the Goldman franchise? Because you talked about lower VaR, so it sounds like you purposely took down risk. But can we just talk through FICC a little?

David A. Viniar

Okay, I'll try. So I said a lot of this in what I started with, but let me just give you a little bit -- a little more, Glenn. We don't believe there was really any impairment of our franchise at all during the quarter, but I don't want to sugarcoat things. I think we underperformed during the quarter. So just a little more on that. Every business, as I imagine, had positive revenues. So it's not like there were big losses somewhere. Volumes were lower, but they weren't a lot lower, which is why I tell that we don't think there was any impairment of our franchise. We have certain -- I mean, it's harder to figure out volumes in some of the FICC businesses than it is in Investment Banking, where you have league tables and you have volume numbers. But we have several measures that we use, and I would tell you that they were down but down modestly. Given some of the macro uncertainties that we saw, many of which were driven by political rather than economic issues -- so they're much harder to analyze, certainly for us -- we didn't manage the market-making inventory that we get as well as we have in the past. That was true across the franchise. It was especially true in Europe and Asia, where many of these macro political concerns existed. As a result, we retained very, very little risk. You saw what our VaR numbers were on average across the quarter, and I will tell you at the end of the quarter, they were even lower than they were throughout the quarter. In hindsight, given the way things unfolded, that may have been a bad decision; it may not have been a bad decision. We don't know, and we may not know for a while, but the position that we made. And again, given that, we -- without sugarcoating, we did underperform during the quarter. Now one of the very, very few quarters since our IPO that we've underperformed, in fact, but we did. We're disappointed in the results. We're glad that it's really nothing to do with our franchise, and we're very focused on doing better in the future.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

All right. I'll take my head in my hands on this one and ask, with risk levels, macro -- still uncertainties still out there and risk still low at the end of the quarter, are we expected that this is a current environment run rate? Or do we get a little bit of reprieve as we move forward from a tough second quarter?

David A. Viniar

I don't think there's such a thing as a run rate in FICC. I don't think there's anything normal. Look, we're 11 days into this quarter, so it's very hard to make assumptions on what's going to happen going forward. And let me give you all the caveats. It's, a, it's 11 days. B, it's the third quarter, which includes August every year, you can't avoid it, it will this year. C, there are other things besides our trading business. And we have, obviously, a position ICBC, other principal investments. You've seen what's going on in the equity market. That's not so good, although that comes and goes. But as far as trading goes, while our risk remains quite low right now, it feels a little better so far in the second quarter. Let me again caveat, that it's only 11 days into the quarter, but so far, it feels a little better.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

The $1.2 billion that you identified earlier in the call, non-comp and comp, can you give us any thought on how much it's weighted towards non-comp and comp? Because I feel like -- and what is outside the normal managing the ratio to the revenue environment? In other words, it seems like you're identifying that $1.2 billion as an above-and-beyond reaction to the environment, regulation, things like that.

David A. Viniar

So a couple of things. First, just to be clear, that's $1.2 billion of run rate. You're not going to see a $1.2 billion reduction in this year's expenses. A lot of that we'll do this year, but you won't see the expenses until next year. Second of all, that does not include -- when I say comp and non-comp, that does not include lowering people's compensation. So that comp would be a reduction of hedge, which would therefore be a compensation -- a reduction in compensation. And look, we think that given, a, some of the regulatory uncertainties, but b, some of the economic uncertainties, it looks like the environment's going to be somewhat slower for the foreseeable future. And so we decided that it made sense at this point to cut some level of expenses to be more efficient.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

And last one is on Volcker timing, do you expect the draft like in the near future? I'm not sure you can comment on your back and forth, but just thoughts on timing.

David A. Viniar

We don't know any more than you know about when things are going to come out. We think that there will be drafts some time this year, but exactly when, we're not sure.

Operator

Your next question comes from the line of Howard Chen with Crédit Suisse.

Howard Chen - Crédit Suisse AG, Research Division

Just revisiting the cost savings, could you just give a sense for how you arrived at that $1.2 billion target? Does that get you to a specific level of expenses or returns across the franchise that you want to -- or that you're comfortable with?

David A. Viniar

I would tell you, a, it's more of an art than a science. It was done business-by-business. We looked at what we thought the opportunity set was going to be going forward, where both business-by-business, region-by-region. So it's not -- while it is somewhat, excuse me, across the board, it's not exactly the same everywhere. And we tried to say what do we think the opportunity's going to be, and how many people do we need, and what do we need to cut back in expenses to have appropriate returns for our shareholders.

Howard Chen - Crédit Suisse AG, Research Division

Okay. And then on this quarter's Investing & Lending results, fairly positive in a more challenging environment for asset prices. So could you give us a flavor for maybe realization versus writeups this quarter, David?

David A. Viniar

Yes. In -- I think that's one of the things that really drove the equity number. There were a fair number of realizations within there. The market were down. So obviously, the mark-to-market on public securities was actually a negative in the quarter. But on the private securities, we're up a fair amount, and of what was up, probably 60% was realized.

Howard Chen - Crédit Suisse AG, Research Division

Great. And then finally for me, your share repurchase activity accelerated to $1.5 billion this quarter. Is that more a function of the stock price or the approval of the Feds capital plan last quarter? I'm just trying to gauge, looking forward -- clearly, a strong confidence-sending message with respect to the reload, but how aggressive you all want to be in terms of the share repurchase?

David A. Viniar

Look, we want to do 2 things. A, as you know, we want to keep our share count at least flat, no more -- no higher than flat from our equity-based compensation. And we do try and adjust it a little bit based on where we think the share price is. And we have very, very strong capital ratios. We continue to generate capital through earnings, as well as through compensation. And so we want to be prudent. We're probably going to keep high-end capital ratios for a while, higher than most others, because we think it makes sense in this market. But we're going to be -- also be prudent in returning capital to shareholders as we think it's okay.

Howard Chen - Crédit Suisse AG, Research Division

Okay. Just a clarification on that maybe, David. When you say high end, I know you've given your Basel III guidance without a lot of -- very conservatively at near 8% last quarter. Is that -- I mean, when you say high end, do you mean kind of near 8% Basel III? Or are you thinking about a Basel I figure, or neither?

David A. Viniar

Yes, yes and yes. Right now, we're under Basel I, and so we're going to -- we have to, obviously, pay attention to that. And we will continue to keep, as I said, high-end capital ratios, without being more specific. But we're also looking out towards Basel III, because we know that's coming. We're -- as we've told you, we're -- we'd be at around 8% if we were looking at it today. If you look out just a couple of years before many of the requirements kick in and you make some assumptions on consensus earnings and just passive mitigation with things just rolling off without us doing anything, you get to like 11%, close to 11% numbers. And so those are pretty high end. I wouldn't expect we'll run things much higher than that.

Operator

Your next question comes from the line of Guy Moszkowski with Bank of America Merrill Lynch.

Guy Moszkowski - BofA Merrill Lynch, Research Division

So you talked a fair amount about the volatility in results in FICC, particularly, I guess, in commodities and mortgage. It does seem to be -- and your European credit. It does seem to be more than usual. I mean, you've always had excellent risk management, but I just wondered if after this bout of revenue volatility, you're looking at making any specific changes in the risk management regime?

David A. Viniar

No. I wouldn't say so. I don't actually think it was a risk management issue. It's, as I said, it's not like we had losses. Maybe we made a bad decision in taking too little risk. I don't know. I'm not sure we would do anything differently with hindsight. And one of the difficult things for us, if you look across the volatility in the markets, a lot of it was driven by political rather than economic issues. That's an environment that's very hard to analyze, very difficult for us. And so in that type of environment, we took risk down a fair amount. And therefore, again, not to pull punches, we underperformed.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Got it. Okay. So yes, I hear you. The -- would you be able to update us a little bit on your exposure to the 5 European countries that everybody's worried about, maybe a gross and a net number, and talk about how you hedged down to the net?

David A. Viniar

I can give you now kind of general as opposed to all the specifics you asked for. On a net basis, Guy, our exposure is actually pretty modest. We have, I would say, total for the 5 that I think you're referring to, between $1.5 billion and $2 billion of exposure. It's really pretty modest.

Guy Moszkowski - BofA Merrill Lynch, Research Division

And in terms of how you get down from whatever the gross number is to the net, obviously, the question that people have in the wake of what happened with the mortgage problem here in the U.S., is that sometimes your hedges -- not yours in particular, but hedges don't work as well as people would have wanted, and you get wrong way risk, counterparties that get into trouble, et cetera. How do you get comfort with where you are on the sovereign stuff?

David A. Viniar

How about if we follow up with you on that offline a little bit, we'll give you some more detail. But I wouldn't -- don't take that to mean anything. Our gross exposure is not all that big either. We're -- we've been pretty cautious in that region for a while, but the net is really modest.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Okay. Fair enough. And then just in terms of headcount numbers, as you pointed out, you're flat versus last quarter. You do have some cost reduction targets. But can you give a sense as to what we should expect in terms of the kind of evolution of your headcount over the remainder of the year and into next year?

David A. Viniar

As we sit here now, and of course, as you know, things can change, the headcount reductions that would be associated with that $1.2 billion I talked about would be in the range of 1,000 people globally. And that would come over the course of this year and then we'll see next year.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Okay. But presumably, we could then actually see a little bit of a boost, though, in the third quarter because of normal recruiting and stuff?

David A. Viniar

No. I took that into account in the number I gave you.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Got it. Okay. Just a final question, and I think last quarter, you helped us understand what the ROE impact was of maintaining the kind of global core excess that you have. Can you give us a sense for what the liquidity drag is at this point?

David A. Viniar

I actually don't know that number offhand, Guy. I didn't calculate it. We'll get it to you.

Operator

Your next question comes from the line Roger Freeman with Barclays Capital.

Roger A. Freeman - Barclays Capital, Research Division

So just to come back to the capital piece here. In terms of net buybacks -- and I think you partially answered this. But given that you've got leading capital ratios among your peers and some of them seem to have authorizations to do more meaningful net buybacks, I mean my question is, is it fair to say that you just haven't asked to do that as opposed to not having been given authorization to do it? And also, as you roll out to that 11 -- call it 11 percentage number under Basel III, I mean, if your minimum is 9%, would you expect to run at a couple of hundred basis points premium to that? Because I thought something more like a 100 is probably where you'd end up.

David A. Viniar

Let me answer the second question first, which is no. We would not expect to run at a 200-basis-point excess over whatever our minimum is. That would be higher. We would expect to run lower than that. I think you're right. Somewhere in the 100-ish basis point range, depending on what the minimum is, might be where we would be. On the first one, but we, without giving too much detail on our conversation with the Fed, we're very comfortable that we have the authorizations we would like to have for the remainder of this year. As you know, that is authorized cap plans for this year, next year is next year. We think we can buy back what makes sense for us to buy back over the rest of the course of this year. We will calibrate that based on performance, share price, the environment and a bunch of other things. But I think we'll be reasonable in our buybacks.

Roger A. Freeman - Barclays Capital, Research Division

Okay. But so then this gets to sort of the other part of the question, which is how do you think about running at capital levels, rolling forward to Basel III, relevant to the implementation days? Because JPMorgan just said that they'll get -- they'll do that when it's required years from now. It sounds like you're basically there, probably your minimum today, or close to it. And would you run at or above the eventual required level as opposed to, say, buying stock back at one times book today?

David A. Viniar

Look, we'll -- we will certainly buy some stock back at one times book today. That's going to make sense for us to do in this environment. We will probably want -- we think the market is going to look at capital requirements. And when the capital requirements are known, they're going to expect people to be there pretty quickly. We'll probably get there pretty quickly, but that doesn't mean we're going to have to run above it.

Roger A. Freeman - Barclays Capital, Research Division

Okay. And then 2 more quick questions. On the hedging that you talked about in terms of some of the underperformance in FICC. On the mortgage piece, I thought that the derivatives underperformed, went down more than cash kind of during that falloff. I would have thought there would have been a better hedge outcome for you if you were short of that.

David A. Viniar

I think what you saw, really, across all credit products, was that cash declined more than the revenues.

Roger A. Freeman - Barclays Capital, Research Division

Okay. Okay. And then the last question. In terms of your expense review, does that have any impact on how you're thinking about growing out the -- your emerging market business? That's where a lot of hiring has been.

David A. Viniar

No.

Roger A. Freeman - Barclays Capital, Research Division

Okay. That continues...

David A. Viniar

No. That is a long-term investment, and we know it, and we continue to be very committed to that.

Operator

Your next question comes from the line Michael Carrier with Deutsche Bank.

Michael Carrier - Deutsche Bank AG, Research Division

Just on the -- you announced the expense initiatives. But with the challenging environment kind of going on over a year: you got fairly challenging capital market conditions, the macro issues. You mentioned whether it's Europe, U.S., economic growth pretty weak. And then the regulatory changes pressuring certain businesses, even some that may otherwise not fall under some of the increased regulation. I guess, are there any businesses -- or how long do you wait till instead of just expense initiatives, you look at any of the businesses that may be better off either being spun off, restructured to compete with some of the peer play, whether it's asset managers, alternative managers, private equity firms? Just any sense on that.

David A. Viniar

We've talked before. There are 2 businesses we had that we knew we were not going to be able to operate in the -- under the Volcker rules. Those being 2 prop businesses, GSPS and Global Macro Prop. We've shut those down. There's no other business that we think we have that we won't be able to operate. Some will have to be smaller. Some will have to be different. In our merchant banking business, we know that we won't be able to have more than 3% equity in any of the private equity funds. We still think that's going to be a really good business for Goldman Sachs. We think it's going to be important for our clients to be able to vest along side of us. We think our franchise will still be able to find really good opportunities, and we think earning fees and overrides on that will be good for the firm. And so that's probably the next business that will be most effective. So, no, we don't think it will be better in someone else's hands. We're still pretty optimistic about that. Now subject to whatever the final rules are, we will continue to evaluate things as the rules come out. And if we think differently then we'll take action. But right now, we don't think that.

Michael Carrier - Deutsche Bank AG, Research Division

Okay. And then as you've had more time to analyze each business, can you give any update on risk-weighted asset, mitigation, opportunities there? And then as well as any areas where you have seen or could possibly have seen repricing in the industry to aid returns?

David A. Viniar

Look, I think that we continue to go through the risk mitigation. We still are several years away from any of those things having to happen. And so we're not really going to take actions now, because it wouldn't make any sense. But we'll continue to analyze those and take actions that are appropriate and, more importantly, not do things that are long dated that will have very high risk-weighted asset charges above and beyond what the returns could warrant. I think the only places that you're really seeing repricing of things is in tranche credit. Anything that's structured credit, which is the things that are most severely hit by the capital rules, you're seeing some adjustment present.

Michael Carrier - Deutsche Bank AG, Research Division

Okay. And then last one just on the Investment & Lending business. You guys provide that sensitivity in the queue, but do you have any color in terms of the portfolio, percent that is public versus private, just in terms of trying to get a sense in the future? I mean, obviously, it's a challenge, but just the portion that's going to be more based on either DCF models and kind of long-term views versus just the public markets?

David A. Viniar

I do not have that with me now. Sorry.

Operator

Your next question comes from the line Kian Abouhossein with JPMorgan.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

A few questions. First of all, the staff number reduction, the net 1,000, can you give us an idea in what business segment we should think about potential staff reduction, as well as at what level? Is it more at the junior level or more at the senior level?

David A. Viniar

I'm actually glad you asked that question, Kian, because I should have mentioned it before. The reason I mentioned the dollars first is because we're much more focused on the dollars that the savings we'll create than the number of heads. And so businesses are actually looking to get to a dollar number. That's why I gave you a number like in the range of 1,000 heads, because it could be somewhat more, it could be somewhat less. And we're still working through exactly what it's going to be from a seniority level, but it's really more dollar focused than head focused. And so it's going to be -- the long way of saying it, it's going to be some more senior, some more junior people. As far as businesses, as I said, I'm not going to be very specific on which businesses. It's not going to be a lot in the growth market, because that continues to be a big strategic plus for Goldman Sachs. And it is broad based, but some businesses more than others.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

And switching to revenues, if I look at some of the competitors who have reported FICC revenues, you look at a decline of about 20%, 27%. Now in terms of run rate, would you argue that is a reasonable number if you take out your trading-related issues?

David A. Viniar

I do not believe there is such a thing as a run rate in FICC. I think it is -- and we've -- you've heard me say this before, I think it's a very dangerous thing when we had our highest quarter ever in the first quarter of 2009, and people said, "Is this the new run rate?" I said, "No. It is not a run rate." When we had our lowest quarter before this quarter, in the fourth quarter of last year and now this quarter, I would tell you, no, this is not a run rate. I think it is very sensitive to what the economic environment is, what the activity levels are and what our clients are doing. And so I think to think that there is a run rate is a very dangerous thing.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

But if I take your second quarter numbers and I'm trying to find out what is kind of a clean revenue number, and I look at some of your peers, which are down more around the 25% level relative to the first quarter, and I assume that against your first quarter, wouldn't that be a good reasonable thing to do considering that's reflective of the fixed income market, to get an indication of what's kind of clean for you?

David A. Viniar

I think you -- if you're saying, is that an indication of what a definition of our underperformance in the first quarter, I mean, you can do that analysis and the numbers are right. To say that that's a good way to model going forward, I just think, you don't know.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Okay. And if I look at your return on equity, 8% in the first half, and it's fair to say that, normally, the second half revenues are always more difficult than the first half, then how should we think about your ROE generation? And can you give us an indication of how we think about the ROE this year, in particular, considering also the second quarter trading issue?

David A. Viniar

So first, just not to pick over this, but in the first half, you're correct. It was 8%. But obviously, the repayment of the Berkshire Hathaway preferred was a really unusual thing. Without that, it would have been 10%. I think our normal desire is to get to 20%. I think it's going to be very tough in this environment, very tough in this year. I'd be surprised if we did that this year. It's very hard for me to target ROEs. Tell me what the economic environment's going to be, and I can do a better job of telling you what it's going to be. But we just don't know what the economic environment is going to be the second half of this year.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Oh, you -- just the comp? You go significantly low on the comp ratio?

David A. Viniar

Again, have a lower comp ratio with lower revenues, it tends to go the other way. But as you know and you've seen the last several years, we're very prudent with our compensation. We take the firm's performance into account. And if performance is lower, compensation's going to be lower.

Operator

Your next question comes from the line Meredith Whitney with Meredith Whitney Advisory Group.

Meredith Ann Whitney - Meredith Whitney Advisory Group LLC

I am going to beat a dead horse a bit on the expenses and ask why the target of $1.2 billion is so low. Is that the first swipe? Because that doesn't really move the needle so much.

David A. Viniar

Well, we hope it's not the first swipe, because it's painful to do, and we don't want to do this more than once. It's based on our assessments of the opportunities set looking forward and how we need to size the firm to take advantage of those. And as I say, it's not a science but more of an art.

Meredith Ann Whitney - Meredith Whitney Advisory Group LLC

Okay. A lot of discussion have gone on this quarter about how total comp is less variable in the industry than it's ever been, and a lot of that was driven by the salary adjustments post to U.K. bonus tax when salaries were re-rated up. Do you think it's possible for the industry then to re-rate those salaries back down? And then on the non-comp side, how much of your non-comp is tied to headcount?

David A. Viniar

Okay. So I think we shouldn't overplay that first part. I think it is true that salaries have gone up. I know they have at Goldman Sachs, probably in other places too. In the context of the percentage of our compensation that is salaries, it's a minor difference versus what it used to be. So I think our ability to manage our compensation expense is still quite high. What was the second question, Meredith?

Meredith Ann Whitney - Meredith Whitney Advisory Group LLC

The non-comp is persistently high. How much is that --

David A. Viniar

Oh, I'm sorry. That's related to hedge. Look, I think there is actually a fair amount of non-comp that is related to hedge, but the second biggest expense after compensation is really a step function expense because it's occupancy. And you have a building or you don't have a building. Most of our buildings are big buildings. And so if we cut some hedge in New York, that wouldn't cut our occupancy expense. There's lots of other non-comp expenses, like travel and telecom and market data and all kinds of things like that, that go with headcount, but one of the biggest expenses does not.

Meredith Ann Whitney - Meredith Whitney Advisory Group LLC

Okay. So my final question is a strategic question around your asset management business. This is -- it's been fine, but it hasn't been a shining star. It would seem now, that would be a business that you would gravitate towards maximizing every potential profit opportunity, every potential growth option. What are you doing in that area?

David A. Viniar

We continue to invest in the business. We think it is a very important business for Goldman Sachs. We think that within the context of the firm, it has the most stable revenues of the businesses we're in. We think that's important. We think that our client relationships give us great opportunities to gather assets. We think that our private wealth business within asset management is a really, really important asset-gathering business and a really, really important business. So we think, look, it's one of the few businesses -- and we know we're not the leader in that business -- and we have real opportunities to grow, and we're very focused on doing that.

Operator

Your next question comes from the line Chris Kotowski with Oppenheimer.

Christoph M. Kotowski - Oppenheimer & Co. Inc., Research Division

Yes. I want to talk a bit about the share purchase reauthorization increase. And first of all, did I hear you correct to say that, that 90.8 billion -- million shares is for between this fiscal year or for 2011? Or does it...

David A. Viniar

That's the total authorization that we have now from the board, not -- from our board's authorization, that's not the Fed's authorization. That's our board's authorization. That's the total that we can buy back over time.

Christoph M. Kotowski - Oppenheimer & Co. Inc., Research Division

Okay. So there's no specific time limit.

David A. Viniar

Correct.

Christoph M. Kotowski - Oppenheimer & Co. Inc., Research Division

Okay. Then philosophically, do you view share repurchases as being limited by the amount of earnings the you generate in a period, meaning the buybacks would be less than you generate? Or could you imagine that in a world where your stock prices, abnormally low compared to historical trading ranges, have tangible book, that you would buy back more capital than you earn in a period?

David A. Viniar

Yes, I -- yes, we could do that. I could imagine we would do that. We're not terribly anxious to decrease our capital, and I don't think we would do it dramatically. But yes, in an environment exactly like you described, I think we absolutely could, and very well might, buy back more than we earned in a quarter.

Operator

Your next question comes from the line Mike Mayo with CLSA.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

If I can just pull the lens back, why did you take so much less risk this quarter? Why did you bring VaR in so much? I'm guessing it's due to the economic uncertainty, but was it also due to some of the regulatory uncertainty?

David A. Viniar

It had nothing at all to do with regulatory uncertainty. It was the economic uncertainty and the difficulty we had in managing the clients' revenue inventory that we had. And we just thought it was prudent given that uncertainty, and the fact that a lot of the uncertainty was caused by political factors that were really, in our view, beyond analysis, caused us to do it.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And can you compare or contrast the U.S. versus Europe versus Asia? When you had wider spreads in the U.S. a couple of years ago, you benefited. I'm assuming you had some wider spreads in Europe, and I just wondered if you benefited from there.

David A. Viniar

Part of the issue, for us at least, as I said with that -- a lot of what was happening in the markets, at least, it felt to us, were not driven by the underlying economic issues but by political issues. Markets were moving based on statements. That's very hard for us to analyze, and we found it hard to take advantage of.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

Is that still the case? Because you say the first few days are going better in the third quarter.

David A. Viniar

I think there's still plenty of that out there. As I said before, our risk remains pretty low, but the performance has been a little bit better. But please remember my caveats about it only being 10 days, and things could change.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And then, separately, how much capital would be freed up if you cleared through a clearing house with your OTC derivative positions? Or at least, how much capital is allocated to the OTC derivatives positions in Basel III terms?

David A. Viniar

Mike, I think the number is about $11 billion or $12 billion, but we'll come back to you to confirm that.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

Okay. So that's how much you have allocated now?

David A. Viniar

Yes.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

Or in that range. So how much, even as a percentage, do you think you could free up if you go through a clearing house? I mean, is it 1/2, 1/4 or 1/3?

David A. Viniar

It depends on what the rules are, what the capital charges are and what -- and how much we clear. So I don't know how to answer the question until we have more clarity on the rules.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

In the past, you implied it would be pretty significant, but you haven't put any numbers to that.

David A. Viniar

We don't know. It depends on what the rule set is.

Operator

Your next question comes from the line Ed Najarian with ISI Group.

Ed Najarian - ISI Group Inc., Research Division

Yes. I think this question's been sort of beaten to death a little bit, but -- and I'm not asking for a long answer. But in terms of the components of the FICC -- of the lower FICC revenue that you were seeing, sort of went above and beyond just the weak customer volume, so maybe beyond that 25% down from the first quarter. Could you give me a little more clarity, I think you're saying on the one hand, we took off risk positions. We saw what -- we took VaR down on purpose, that had an additional revenue -- negative revenue impact. But were there actual -- were there some actual inventory positioning losses that you absorbed above and beyond that? Or could you just sort of give a little more color on that lower risk, lower VaR sort of portion of the underperformance or, potentially, actually taking losses on the trading inventory?

David A. Viniar

It's very hard to quantify. And again, I don't want to sugarcoat this and say, "Oh, no big deal. We just took risk down." We underperformed in the quarter, so I don't want to sugarcoat it. Now there were reasons behind it, but we did, and I want to make sure you hear that. We did take risk down during the quarter. Hard to quantify if we had not taken risk down, what would our results have been. It's very, very hard to quantify, because it depends when and what and how, and it's impossible to go back and know that. I've mentioned every business had positive revenues. So it's not -- and that doesn't mean that on any day, we didn't have losses. We had lost days. You'll see that in the Q. It doesn't mean that certain positions didn't go the wrong way. They did. But overall, when you look over quarter, every business had positive revenues.

Ed Najarian - ISI Group Inc., Research Division

So David, is it fair to sort of say then that, okay, the environment was tougher, in that your customer volumes were less. That's number one. Number two, Goldman Sachs sort of went above and beyond what other peers did in terms of reducing VaR and reducing their risk position. So that's number two. But even in the midst of that, it did take at least some positioning losses in commodities or other areas on inventory, because the hedging environment was so difficult. That's number three. Are all those 3 things fair statements for that reason, that the revenue is down versus the first quarter on FICC?

David A. Viniar

The only thing I would adjust a tiny bit to what you said, you compared our risk to others' risk. I only know -- I only really focused on ours. We took ours down. I couldn't say we took it down more than others or less than others, but yes, we took ours down. You make that one adjustment, I think everything else you said is correct.

Operator

Your next question comes from the line of Fiona Swaffield with Royal Bank of Canada.

Fiona Swaffield - RBC Capital Markets, LLC, Research Division

I just have a couple of questions. The first thing is I'm just trying to understand the timing on how the shares move under buyback or how you get obviously new shares for compensation. Is it -- you're saying you want to keep your shares flat. Does that mean that the reduction is just a timing issue, so we'll see new shares coming in, in the second half? And that was my first question. My second question was on risk-weighted assets and your comment that you didn't feel the need to do mitigation now. I'm just wondering what you're feeling about correlation, because some of your peers are taking quite a lot of action on their correlation trading books and seeing quite a lot of mitigation. I'm just was wondering what your view is there. And then lastly, I know we've really talked about FICC a lot, but is there a factor at all or is it relevant that the ABX was so volatile towards the end of the quarter? And does it matter? Do you think there's a factor in terms of how people may have interpreted the pricing towards the end of the quarter or not?

David A. Viniar

Okay. Let me try and do that, but I may make you repeat your third question. Okay. On share count, shares come in over the course of the year on compensation. I can't remember exactly how many, but over the course of the second quarter, for example -- we can get back to you, but some number of shares came into share count during the second quarter. Those were part of our calculation of share repurchased during the second quarter. The same thing will happen in the third quarter and in the fourth quarter, and it happens throughout the course of the year. So compensation shares -- and we're happy to do offline and talk to you about how the accounting works on that -- come in over the course of the year, and we try and buy back at least that much so that we keep our share count each quarter flat. Second, on correlation, that's what I was talking about before with all kinds of structure credit and tranched credit are probably the things that are affected most by the Basel rules. And what I would tell you there is there's just not as much activity there as there has been in the past, and we'll be probably less aggressive in doing new trades there. And can you repeat the third question on the ABX?

Fiona Swaffield - RBC Capital Markets, LLC, Research Division

Can I just come back to that correlation? But some banks seem to be saying they're actually taking action to reduce their business significantly than take away legacy, just to downsize it in advance.

David A. Viniar

I understand. I told you kind of what our thoughts were there.

Fiona Swaffield - RBC Capital Markets, LLC, Research Division

Okay. And then I'm just wondering about volatility in the index and whether there's a factor in terms of how could it move so quickly. Some of the pricing was so crazy toward the end of the quarter.

David A. Viniar

Well, I would say just a little differently. I think you saw a pretty precipitous decline in the price of non-agency residential mortgages over the course of June. So I think the ABX was just an indication of that, but I think you did see prices decline in non-agency mortgages over the course of the latter part of the quarter.

Operator

Your next question comes from the line Matt Burnell with Wells Fargo securities.

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

Just one final question, hopefully, on the more challenged European economies. In the first -- at the end of the first quarter, according to regulatory data, you all have what appears to be gross exposure to those 5 countries at about $10 billion focused in 2 of those countries. In the -- at the end of the second quarter, was that "gross exposure" materially different?

David A. Viniar

I actually -- not trying to not answer, I don't have that information with me. I know the net, but I don't know the gross.

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

Okay. And very small administrative question. What was the DVA amounts in the trading numbers this quarter?

David A. Viniar

Oh, sorry. It was less than $100 million, and it was probably 60-ish percent and, in fact, up 40% in equity, something within that range. It was less than $100 million. It was very small.

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

And just pulling the plane up a little bit, do you have any comments related to what the effect on your business might be from a downgrade of the U.S. sovereign credit. And some of the comments that Treasury Secretary Geithner made earlier this week seem to suggest a -- maybe a return to a more adversarial relationship with the financial services sector. I'm just curious as to your thoughts about are we going back to a more -- a tougher environment with DC.

David A. Viniar

First of all, I'm not going to make a lot of comments on what would happen if there was a downgrade of the U.S. I just hope that it gets resolved, and I suspect that at some point, it will get resolved. And no, I don't see a tougher environment between financial services and DC. I think the regulatory community is trying to do the right thing and get things right and do things that are going to protect the financial system going forward.

Operator

At this time, there are no further questions. Please proceed with any closing comments.

Dane Holmes

Thank you, everyone, for joining us for our 2Q earnings call. If you have any incremental questions, please feel free to contact us at the Investor Relations department, and we'll be happy to respond. Thank you, and have a nice day.