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 Third Quarter 2012 Earnings Conference Call.

[Audio Gap]

call is being recorded today, Tuesday, October 16, 2012. 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 Third 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 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 2011.

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 at www.gs.com.

This audiocast is copyrighted material of The Goldman Sachs Group, Inc., and may not be duplicated, reproduced or rebroadcast without our consent.

Our Chief Financial Officer, David Viniar, will now review the firm's results with Harvey Schwartz who will assume David's role at the end of January. David?

David A. Viniar

Thanks, Dane. I'd like to thank all of you for listening today. I'll give an overview of our third quarter results and Harvey will review our business performance.

Net revenues were $8.4 billion and net earnings were $1.5 billion. Earnings per diluted share were $2.85 and our annualized return on common equity was 8.6%. Year-to-date, our annualized return on common equity was 8.8%.

The third quarter operating environment included continuing concerns about the outlook for the global economy, particularly as it relates to the situation in Europe. The uncertainty surrounding economic prospects has weighed on the psychology of corporate leaders and investors, negatively impacting the current operating environment in 2 principal ways.

Corporate client activity continued to be relatively weak in the third quarter. Industrywide, announced M&A volumes declined 16% sequentially and IPO volumes were nearly cut in half. In addition, New York Stock Exchange volumes were down 13% sequentially, while LSC volumes were down 23%.

An additional impact of economic uncertainty and weak investor conviction is the tendency for investors to transact in the most liquid and commoditized portion of the market. This dynamic is evident within both the FICC and equities franchises, as demonstrated by the significance of index product volumes in credit and equities.

Although client activity remains muted, there were some favorable developments during the third quarter. The United States Federal Reserve announced a further increase in monetary stimulus, and the ECB stated that it would support the euro and was prepared to make outright purchases in the secondary bond market to address severe distortion in government bond markets.

Since the ECB's pronouncements, Spain and Italy's 5-year CDS spreads have each tightened by over 200 basis points, reflecting the market's diminished view that a tail event will emanate out of Europe. While these positive developments have created some optimism in the marketplace, we as a management team remained focused on guiding the firm through a continued difficult operating environment. We are serving our leading client franchise, managing our risk profile prudently and being disciplined about capital usage and operating expenses.

Harvey will now review each of our businesses. Harvey?

Harvey M. Schwartz

Thanks, David.

Investment Banking produced third quarter net revenues of $1.2 billion, down 3% from second quarter results. Third quarter advisory revenues were $509 million, up 9% from the second quarter. Year-to-date, Goldman Sachs ranked first in announced and completed M&A globally. We advised on a number of significant transactions that closed during the third quarter, including Amylin Pharmaceuticals' $7 billion sale to Bristol-Myers Squibb; NDS group's $5 billion sale to Cisco; and CGI Group's $3.2 billion acquisition of Logica. We also advised on a number of important transactions that were announced during the third quarter, including Nexen's $19 billion sale to CNOOC; Amerigroup's $4.9 billion sale to WellPoint; and Fraser & Neave's $4.5 billion sale, with interest in Asia Pacific Breweries, to Heineken.

Third quarter underwriting net revenues were $655 million, down 11% sequentially. Equity underwriting revenues of $189 million were down 21% from the second quarter, reflecting weaker IPO activity. Year-to-date, Goldman Sachs was ranked first in global equity and equity-related and common stock offerings. Debt underwriting revenues decreased 6% to $466 million.

During the quarter, we participated in many noteworthy underwriting transactions, including Whole Logic's $3.5 billion combination term loan and high-yield notes offering; Dollar General's $2.1 billion follow-on offering; and Seadrill's $1 billion high-yield note offering. Our Investment Banking backlog decreased slightly from the end of the second quarter levels but remains higher than the end of 2011.

Let me now turn to Institutional Client Services which is comprised of FICC and equities client execution, commissions and fees, as well as security services. Net revenues were $4.2 billion in the third quarter.

FICC Client Execution net revenues were $2.2 billion in the third quarter and included a DVA loss of $225 million. Excluding the impact of DVA, revenues were up 11% sequentially. Our rates business benefited from improved client risk appetite related to central bank activity during the quarter. Mortgages was aided by improving housing fundamentals and strong customer demand. Credit results reflected solid client activity levels. Commodities and currencies were both negatively impacted by continued low levels of volatility and volumes.

Turning to Equities which includes equities client execution, commissions and fees and securities services. Net revenues for the third quarter were $2 billion and included $145 million in DVA losses. Excluding the impact of DVA, revenues were up 26% sequentially.

Equities client execution revenues increased 66% sequentially to $847 million, reflecting a more benign market-making environment. Commissions and fees were $721 million, down 7% from second quarter on lower volumes. Securities services net revenues of $392 million were down 4% from the seasonally stronger second quarter.

Turning to risk. Average daily value at risk in the third quarter was $81 million, down 12% relative to the second quarter.

Let me now review Investing & Lending, which produced net revenues of $1.8 billion in the third quarter. Our investment in ICBC produced a gain of $99 million in the quarter. Other equity investments generated net revenues of $824 million, reflecting gains that were primarily driven by private equity investments. Net revenues from debt securities and loans were $558 million, largely driven by a more favorable credit market, with tightening credit spreads and interest income. Other revenues of $323 million were primarily driven by the firm's investment in consolidated investment entities.

Switching to Investment Management. We reported third quarter net revenues of $1.2 billion, down 10% sequentially as the firm booked onetime incentive fees related to the sale of our client's remaining investment in ICBC in the second quarter. Management and other fees were consistent with the second quarter at $1 billion. During the third quarter, assets under management increased $20 billion to $856 billion due to market appreciation.

Now moving on to our expenses. Compensation and benefits expense, which includes salaries, bonuses, amortization of prior year equity awards and other items such as payroll taxes and benefits, was accrued at a compensation-to-net revenues ratio of 44%. This is consistent with the firm's accrual for the first half of 2012.

Third quarter non-compensation expenses were $2.4 billion. We continue to be focused on our cost-saving initiatives, and year-to-date, our non-compensation expenses are running 10% lower than the first 3 quarters of 2011.

Total staff at the end of the third quarter was approximately 32,600, relatively flat with the second quarter of 2012.

Our year-to-date effective tax rate was 33.5%.

During the quarter, we repurchased 11.8 million shares of common stock for a total cost of $1.25 billion. Today, we also announced an increase in our quarterly common stock dividend from $0.46 to $0.50 per share.

Now let me turn it back to David to make some concluding remarks.

David A. Viniar

Thanks, Harvey.

As a management team, we are keenly aware of the fact that we cannot control the broader economic environment in which we operate. As we've said many times in the past, the firm will perform at its best and our shareholders will benefit to the greatest degree when we're in a more robust economic environment. However, a difficult operating environment does not absolve us from our responsibility to manage everything that is within our control to create best-in-class returns over the long term.

We must be disciplined in managing both our operating expenses and capital levels. As it relates to operating expenses, we have to balance lowering costs and maintaining high levels of client service. In the second quarter of 2011, we announced a $1.2 billion expense reduction initiative. Since that initial announcement, we've increased the target expense savings by nearly 60% to $1.9 billion. We believe that we've been able to undertake these initiatives without materially impacting our client franchise. And as a consequence, we should be well positioned to create operating leverage in an improved economic environment.

Regarding capital management, we've been extremely focused on balancing the competing objectives of returning excess capital to shareholders with the prudence associated with maintaining conservative risk-adjusted capitalization in a difficult operating environment with undefined capital rules. Since the onset of the financial crisis, our risk-based capital measures have remained at or near the top of the industry. While Basel III capital rules are not finalized and will not be fully phased-in for many years, our best estimate from what we know today is that, at the end of the third quarter, our Basel III Tier 1 common ratio would be approximately 8.5%. We expect that we will ultimately operate with a capital cushion in the proximity of 100 basis points versus our regulatory requirement.

We've remained committed to maintaining a conservative financial profile and have a deep appreciation for the strategic benefits, both opportunistically and defensively, that come with maintaining robust capital levels. While not wavering from that view, we've been able to repurchase $9.1 billion of common stock since the beginning of 2011 and have reduced our basic share count by 11%. As Basel III rules have started to be finalized and we are closer to implementation, we've begun to focus on optimizing our balance sheet in preparation for these changes. We've previously announced that we expected $88 billion of risk-weighted assets to passively roll off by 2015, and we have begun to roll out the necessary tools to facilitate a more active approach to mitigating risk-weighted assets.

We're committed to managing our operations, with a focus on serving our clients effectively. As a result, we manage our expenses and capital, with the understanding that our shareholders have invested in this franchise, with the expectation that we will outperform over the long term.

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

Question-and-Answer Session

Operator

The first question comes from the line of Glenn Schorr with Nomura.

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

So I -- you noted the 11% share count reduction since the end of '11. I just want to ask maybe semantics on the quarter. Share count was down almost 2% in the quarter, but it's only down about 2% year-to-date. Is that a function of the stock going back up and just that fully diluted options count?

David A. Viniar

I think it -- that's partially what's in it. And the way diluted and basic share count work is a little bit different, Glenn, as I think you know. Basic is a point in time, diluted is an average over the period. So you -- and diluted is what we use for EPS, basic is used for book value per share. So you just have to be a little careful when you're comparing those numbers. And we're happy to get you the breakdown of all of them, if you like.

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

That -- no problem. I'm -- the question is more of, you've been buying back at a nice pace and it's made a good dent in the share counts over the course of the last 2 years. You just saw less of it. And I know I'm doing apples and orange. I'm asking specifically in the quarter, I would have thought the fully diluted share count might have been down more year-to-date, and I just don't know if that's just a function of more shares going into the fully diluted count just because of improvement in the shares.

David A. Viniar

Why don't we do the calculation and we'll come back to it?

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

No worries. On Investing & Lending, anything you can tell us on realized versus unrealized because I heard your comments about private equity on the equity line, but just curious on what's realized versus unrealized.

David A. Viniar

I don't have the exact numbers. There was more unrealized than realized. Many of the private was unrealized. And we told you it was primarily -- although a lot of that -- part of that was based on performance, part of that was based on the markets and part of that was based on events happening even within private companies, but it was more unrealized than realized.

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

Okay. And then on the $1.9 billion, I mean, to me this is maybe a little more art than not, but how much of that is actually been able to make its way to the P&L yet? Because a lot of this comes through headcount-related items that kind of linger as that phases through. So what is still on the COM [ph] on that $1.9 billion into the P&L?

David A. Viniar

Most of that has been realized or, if not, will be realized by the end of the year. Virtually all of it will be realized by the end of the year. Now remember, part of that is non-comp, part of that has to do with people. And it's not -- and that -- it doesn't include reducing compensation, right? It would only be reduction of the compensation of people who are no longer here. But all of that either has been or will be realized by the end of this year.

Operator

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

Roger A. Freeman - Barclays Capital, Research Division

Just -- I guess, on -- your liquidity levels are still running kind of right up around record levels. And just thinking through the still-cautious approach to managing balance sheet, capital, it feels -- is this level something that over time comes down meaningfully or we going to see as the sort of permanently higher level of liquidity? I assume -- I mean, I assume this is a peak level, but at -- what kind of range relative to where you used to run, which I think was like 1/4 or 1/2 of this, do you think it may eventually get back to?

Harvey M. Schwartz

Well, this is Harvey, Roger. So what I'll say is, if you think about the current environment, well, David, in our opening remarks, highlighted the fact that there's certainly been some positive events globally. It's still a market environment where we're remaining pretty defensive. So I think it'd be really difficult to give you a sense of how the forward liquidity profile would look. But I think you should assume that we'll stay conservative for the time being, certainly.

Roger A. Freeman - Barclays Capital, Research Division

Okay. And then just your -- you said, I think, you'd anticipate running, on a Basel III capital ratio basis, your Tier 1 common at 100 basis points or so, a sort of buffer to your requirement. Is that to -- should we assume that you kind of build to that buffer and in the meantime kind of remain at your -- I guess, your pattern of not buying in excess of the net income before you were to do anything more meaningful, if you chose to do that?

David A. Viniar

Look I think it's a fair assumption that we will build to that buffer. Remember, the full Basel III requirements are not in until 2019 so there's a long time till those requirements are in. Now it's not to say we're not going to get there till then. I'm sure we'll get there well before that. But yes, I think it's fair to assume that we will build to that buffer, and I think it's also fair to assume -- you can't look at any quarter, or even any year, but over time, it's not likely that we're going to buy back more than our net income. That would -- that's not a prudent way and you can't really operate on that basis. In any quarter, we might. In any year, we might. But over time, we're not going to.

Roger A. Freeman - Barclays Capital, Research Division

Okay. And then on the -- still staying with the private equity portfolio: Where do you think you are in terms of wanting to monetize a lot of that? Because it's probably pretty seasoned at this point. And obviously, other private equity firms are trying to, where they can. Should we see -- expect to see that pick up?

David A. Viniar

I -- we will monetize as opportunities arise. I don't think -- we're not in a mode of forcing monetization before it makes sense, but when opportunities arise and we think there's good transaction that can be done, then we'll monetize them.

Roger A. Freeman - Barclays Capital, Research Division

Okay. And lastly, maybe Harvey, the Equities business had a nice sequential comparison. I suspect a lot of that was equity derivatives. Can you talk a little bit to how sort of broad-based that was or if that was -- if it's pretty sort of chunky-structured equity derivatives? Any color there?

Harvey M. Schwartz

There was -- it was a more benign environment for trading in terms of risk management. So that was certainly prevalent in the numbers, but overall, it was really broad-based performance. And we really benefited from the global footprint and diversification of the businesses from brokers all the way through execution.

Operator

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

Howard Chen - Crédit Suisse AG, Research Division

David, Harvey, just on the risk-weighted asset mitigation. David, if I look at the backdrop, on one hand, there appears to be a really strong bid for credit, mortgage. Other things will be higher rated. And then on the other hand, we're seeing some clarity to Basel 2.5 and III rules coming into focus. So I was just hoping you could comment on the environment and maybe your appetite to perhaps accelerate risk-weighted asset optimization or other opportunities, maybe dispose of them, given those 2 dynamics, if you agree with them.

David A. Viniar

I think the real answer, Howard, is we're just going to have to see over time. As I said, we're just beginning to roll out the tools to do it. In the quarter that we've really just started, our Basel III ratio, again as best as we can calculate it, there's still a lot of assumptions, up by 0.5%. And I'm not saying that's going to happen every quarter. But I think, when we give our traders the tools to optimize and figure out what securities or what derivatives are better to hold, what things are better to hedge with, some things that don't make sense they will sell, some things they will keep and just keep in different forms, I think we'll probably start making some substantial progress.

Howard Chen - Crédit Suisse AG, Research Division

Okay, great. And then a follow-up on the revised Basel III guidance -- that's very helpful. Just 2 follow-up questions. Does the 8.5% and the 100 bps buffer, does that incorporate the G-SED [ph] buffer? And then how does internal model approval factor into that guidance?

David A. Viniar

Well, the 8.5% is where we are approximately today and the 100 basis points buffer will be from whatever our full requirement is which, as you know, we don't know yet. But whatever that is -- yes, and again, don't hold me to it. It's not going to be exactly 100 basis points. It will be in that range and it will bounce up a little higher and a little lower and -- but that's around where we're going to run.

Howard Chen - Crédit Suisse AG, Research Division

Okay, great. And then I just wanted to revisit this one last time. Just if we look at this quarter's results, the firm remains in that "liquidity high, risk low" type of profile. I mean the pressure around the central bank actions, the progress in Europe that you noted, David. Is there -- was there any change in that outlook as you exited the quarter? And if not, what are you specifically looking for to make that call to maybe rebalance and remix a little bit between the liquidity and the risk?

David A. Viniar

So first thing, most important thing, is what our clients do. And so again, there's -- as our clients get more active, we will have more opportunities to take risk, and we probably will to some extent. But there's still -- the -- while activity might have picked up a little bit towards the end of the quarter, it was certainly not a very, very large increase at all. And second of all, the traders themselves have to be more comfortable that the market environments are being driven by economics, as opposed to by politics, and I think maybe you've had a slight shift to that but not a big shift at all. So I think those are the things to really look for.

Operator

Your next question is from the line of Kian Abouhossein with JPMorgan.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

I -- on your Tier 1 guidance of 2013, you said 10%. Now you're running at 8.5% at the moment.

Just wondering if there's any change to that 10%. And second question on capital in that respect is regarding the $89 billion (sic) [$88 billion] of runoff that you've indicated between 2011 to 2013 in one of the presentations earlier this year. Was wondering if you could give us an update of how much of the $89 billion (sic) [$88 billion] you've done. And how would this $89 billion (sic) [$88 billion] look like, including additional active mitigation?

David A. Viniar

Okay. So let me just clarify, Kian: What we said for the end of 2013 was not that we were going to run at 10%. This is just pure math. We said, if you take where we are now, if you assume the consensus estimates for us and you assume just the passive roll-off of assets, so no active mitigation, that would get us to 10% with nothing else: no buybacks, no equity issuance through comp. So just pure math, that gets you to 10%. So that's what the 10% number is, I just want to clarify. And as far as the roll-off, again, that $88 billion is through 2015. That's what all the roll-off would be through 2015 and that was largely from basically 6 securitized assets from tranche credit in the correlation book and the mortgage book. So again, that's just to clarify what those numbers were. As far as the active mitigation, we're going to have to see. I mean, that's -- it's hard to put a number on that. As I said to the last question, we've just started to roll out the tools for that. We made a lot of progress in one quarter, and we'll see. History tells us that we do a pretty good job of optimizing these positions as the rules get more clarified and as our traders have the right tools, but we'll see over time.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Okay. And in terms of internal models, are your internal models all at approval stages? Or are there still outstanding internal models for your calculation? Are you giving us a number including internal models that you assume will be approved or -- by the Fed, or is that excluded and that could be on top? And if it's on top, how much would that be in terms of risk-weighted asset decline?

David A. Viniar

Again, it's very hard, very hard to calculate. There are some models that have been approved, there are others that are in process and there are many more that we will then go to the Fed. And as they get approved, if they get approved, then it will help the ratios. And if they don't, then we'll have to do more mitigation. And we'll just have to see over time with what, as well.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

What's your thought on CoCos, on top of the regulatory requirement and the 100 basis points? Do you think you need CoCos or you will participate in CoCos?

David A. Viniar

Those are not included in any of the numbers that I gave you. And again, we'll have to see what regulations are and what's allowed and what's not allowed, and then we'll make our decisions at the time.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Okay. Lastly, investments. Where do you see investment opportunities in terms of staff numbers and in terms of capital?

David A. Viniar

Well, look, we've said this before. In the -- certainly, in the medium term, we think that there are -- although it will be far from a straight line up, we think that the growth markets continue to provide very good medium- to long-term opportunities for the firm. As you know, we do best where there is good growth, where there's good economic growth. It is pretty clear that there's going to be better economic growth in some of the growth markets than in some of the developed markets, and so those are places where we will continue invest. It's not going to be a straight line up. That's not to say we're not going to invest in the developed markets as well. The U.S. market, the European markets where we think, despite some of the economic issues, there are very good near-term opportunities for our business are places that we will invest as the markets get better over time. But certainly, over the longer period of time, I'd say the growth markets probably will have more investment.

Operator

Your next question is from the line of Betsy Graseck with Morgan Stanley.

Betsy Graseck - Morgan Stanley, Research Division

A couple of questions, one on the equity line. I'm just wondering, how much did Knight contribute to the line this quarter?

Harvey M. Schwartz

So as I said before, the equity line in the business was quite diversified. As reported in the press, we did execute the Knight transaction and we were quite pleased to be able to work with Knight to help them manage that risk profile. But at this stage, we won't speak specifically about that transaction or any other transactions as it relates to its contribution to the line.

Betsy Graseck - Morgan Stanley, Research Division

Okay. And then your equity VaR efficiency obviously went up significantly in the quarter, right, since -- given the revenues. And then the equity VaR was down Q-on-Q. So should we -- you're kind of suggesting that, that level of VaR efficiency should persist into the future. Is that a fair takeaway?

David A. Viniar

That is a very hard question to answer. We -- I bet you, if you looked at our revenue-to-VaR, it was different every quarter since we've been a public company. So I -- so it can be very hard for me to say it's going to continue at that level. Clearly, it was a better environment, that's why we said it's more broad-based, but there will be quarters when it will be better and some where it won't.

Betsy Graseck - Morgan Stanley, Research Division

Okay. And then on the -- just one more question on the Basel III. So you indicated that you were -- 8.5% has some model approval in it, and if the regulators have not approved your models, then that is not embedded within the 8.5%. Is that an accurate representation of what you said?

David A. Viniar

Yes. That is largely accurate, yes.

Betsy Graseck - Morgan Stanley, Research Division

And the CRM model approval, is that -- has that been approved or...

David A. Viniar

Betsy, how about, if you want a lot of details about this, we get back to you and go through it with you?

Betsy Graseck - Morgan Stanley, Research Division

Yes, fine. And then just lastly on the share count. The Buffett-related warrants came back into the share count this quarter, isn't that right?

David A. Viniar

To some extent, yes. That -- again, that goes with share price. The way that works is, as the share price goes up and gets closer to $115 and, obviously, above $115, they start to come in and then they continue to come in more as the share price goes up.

Operator

Your next question is from the line of Mike Mayo with CLSA.

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

I know David, you've often said, "Live to fight another day," over the past year or so. And I noticed that your VaR went down from $92 million to $81 million, link quarter. So -- and Harvey, if you have anything to share on this too -- are you still conducting with an attitude "Live to fight another day?" Is reduction in VaR evidence of that, or is reduction of VaR evidence of simply lower volatility? And when are you willing to take on more risk?

David A. Viniar

So I'll answer, Mike. I mean, the answer to both those questions are yes and yes and yes -- I guess, to all 3 of them. There was somewhat-lower volatility that contributed as well. But I think that, really, it's back to what I said before: Our clients are not that active and so there aren't that many opportunities. And as far as the people on the frontline too aren't actually taking the risk, there's still so much political uncertainty out there that's driving markets. A speech by politician x or politician y drives markets up or down as much as any economic situation. And in that environment, it's very hard to have conviction and very hard to take risk both for our clients and for us. And I think, until you see that change a little bit, you won't really see our risk go up dramatically.

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

If you were to neutralize the effect of lower volatility, would your VaR have gone down or would it have been flat?

David A. Viniar

I believe it still would have gone down somewhat. And I can come back to you with the exact amount.

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

But just, conceptually, you pulled back risk even more than you had last quarter. Did anything get incrementally worse that caused you to do that, then?

Harvey M. Schwartz

No. As David said, what really drives risk-taking in the franchised businesses is the client activity. And if you think back to the beginning of the quarter, there was still a fair bit of uncertainty that clients were dealing with and, even now, the discussions around fiscal cliff and everything else. This is a difficult environment for clients because they're very happy to transact and execute on fundamentals, but positioning their own capital against a backdrop of high policy risk creates a conservative environment. So there's certainly no specific efforts to drive down risk-taking, it's really a reflection of the volumes and client appetite, as David said.

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

And then lastly, so far this quarter, client activity, you've mentioned, started last quarter, pulling back risk. Are you maybe thinking of taking more risk? Or are flows better now than they were for last quarter?

Harvey M. Schwartz

I think it's too early to really extrapolate much from the first couple of weeks. But as we've seen in the U.S., equity volumes have been down a touch, and we'll just have to see how the quarter progresses.

David A. Viniar

So far, it's largely been more of the same.

Operator

Your next question comes from the line of Brennan Hawken with UBS.

[Technical Difficulty]

Brennan Hawken - UBS Investment Bank, Research Division

small, but it was the second one this year, so...

David A. Viniar

Brennan, we missed the beginning of what you said, so maybe you could start over?

Brennan Hawken - UBS Investment Bank, Research Division

So I know that dividend increase was small, but it was the second increase this year. So I guess I was just curious whether or not that was part of the CCAR plan initially. Or was it a choice to shift a small amount of money from buybacks to the dividend? And if that's any kind of indication of anything...

David A. Viniar

No, it was consistent with our CCAR approval. And again, while it was small, it was -- we've gotten feedback from our shareholders that they would like it, but I think you should expect, going forward, that much more of our capital planning will be around buybacks. Not to say we won't increase dividends again, but the big portion of our capital planning will be around buybacks.

Brennan Hawken - UBS Investment Bank, Research Division

Okay, okay, great. Also, is there any way -- or could you give us any updated way to think about core or recurring revenue within the I&L line? I know it's tricky, but any color you could give there might be helpful.

David A. Viniar

It's very hard to do. It is somewhat driven by markets, by credit spreads, also by the performance of our specific investments matters. So I think that one is very, very hard to predict, going forward. If I gave you a number, I would really be making it up.

Harvey M. Schwartz

The way I would think about it is, as a result of the Business Standards Committee, when we reframed the financials, it was really an effort on our part to give you more transparency.

Brennan Hawken - UBS Investment Bank, Research Division

Sure. I was just trying to think of whether or not there's -- there were a certain amount of income that kicks off from the dividends and yield and such that you could think about as sort of a baseline number.

David A. Viniar

There's a few hundred million dollars of interest income that's in there, and something like that will be every quarter. But I think that will largely be overwhelmed by some of the movements in the other positions. That's in there and that will be in there, plus or minus a little bit, every quarter.

Harvey M. Schwartz

It's really going to be -- it's really more driven by asset prices.

Brennan Hawken - UBS Investment Bank, Research Division

Sure, okay. And then last one for me is, as far as the pending swaps clearing rules, when you guys are thinking about this coming into effect here in the next few quarters, do you think that the buffering current pricing of the product works given the enlargement in capital requirements? And how do you see this playing out? How are discussions with your clients going as far as changing? Do you think that the change will be more on the product innovation side, or the pricing side? How do you think about that?

Harvey M. Schwartz

Well, when we think about clearing -- as you know, we've been big supporters of clearing. We think it's fundamental to systemic risk reduction. So we've been big proponents, moving clearing forward as quickly as possible. And against that backdrop, we've been building and developing in our business the ability to provide client clearing and the tools and technology and appropriate staff. I'd say that it's probably too early to tell ultimately where we come out with pricing. Like a lot of things, I think there'll be a fair degree of early competition. But we're really in the early innings of this so we'll have to see how the revenue model evolves. But I think the biggest issue is that it fundamentally makes the system safer. And I think -- over time, again difficult to speculate, I think -- as we get clarity around regulatory reform, I think all of these pieces, as they come together, could contribute to greater volumes. So again, difficult to model the revenue outcome.

Operator

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

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

David, you mentioned that the backlog is down a little bit quarter-over-quarter. I guess I'm just curious as to -- if you can -- if you would provide some color as to what's driving that.

David A. Viniar

It were -- when I -- you should just -- I should emphasize the word "slightly" when I say it was down quarter-over-quarter. But it really was a very slight decline. As I said, it's still higher than it was at the beginning of the year and it's a very, very slight -- it's a slight decline in the underwriting part, a slight increase in the merger part, and the underwriting decline is a little bit more than the merger increase. But these really are small numbers when I tell you, "up and down."

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

Okay. And then just one question on I&L balances. Now that you've had a little bit more time to think about the NPR that came earlier this year, do you have any more thoughts on potentially pairing some of the I&L balances?

David A. Viniar

As I said before, I think we're going to -- when there are good opportunities to sell -- again, some of these things will season naturally. It will be time for them to be sold, and we will sell them. And these things will naturally roll off over time kind of as the Basel rules kick in.

Operator

Your next question comes from the line of Douglas Sipkin with Susquehanna.

Douglas Sipkin - Susquehanna Financial Group, LLLP, Research Division

Just a couple of questions. First, I've noticed you guys have introduced preferred stock back into the capital structure, it's modest. But any color on the rationale? I think it's been 2 quarters in a row where that's increased.

David A. Viniar

Well, those were -- we had these Apex transactions which needed to be remarketed. So these were kind of the end of transactions that were done several years ago. There was nothing new there.

Douglas Sipkin - Susquehanna Financial Group, LLLP, Research Division

Got you. Okay, so then there's no really change in thought process of capital management, it's just a function of the expiration of those.

David A. Viniar

That was what those were in there. We'll continue to monitor the markets and see when is the right time to do things and when it's available. But for -- those transactions were older transactions.

Douglas Sipkin - Susquehanna Financial Group, LLLP, Research Division

Got you. Second question. I picked up that you mentioned there was maybe some improvement throughout the quarter, but I guess it wasn't that significant, in terms of activity levels coming in versus leaving the quarter.

Any particular products, it sounds like mortgages was one of them, where there was a noticeable improvement versus -- coming into the quarter versus leaving?

Harvey M. Schwartz

What we saw over the quarter, particularly as the central bank activity picked up, is you really saw capital moving into things like treasuries and mortgages. There was certainly, as we've all seen, a desire to focus on yield-offering products so we've seen the calendar in the debt markets be quite active. Away from that, I wouldn't make any significant comments about the terms of the flows.

Douglas Sipkin - Susquehanna Financial Group, LLLP, Research Division

Got you. Okay. And then sort of -- I think I know the answer, but with respect to cost cutting and headcount levels, it feels like the most recent initiative will take you guys to where you want to be, given the environment that we're in.

David A. Viniar

It'll take us where we want to be for now, and then we'll see kind of how things unfold. And we'll decide if we need to grow, shrink or stay the same based on how the environment feels.

Douglas Sipkin - Susquehanna Financial Group, LLLP, Research Division

Got you. And then just last question for me. It feels like we get close to seeing a stronger M&A environment, but then it peters out. How much do you think the fiscal cliff uncertainty is weighing on CEOs' confidence and, if somehow we can get past this with everyone feeling good, it would serve as a catalyst? Or are there bigger issues with respect to bigger M&A tickets?

David A. Viniar

I think the political uncertainty out there has been a big part of what's kept the M&A calendar as low as it's been, with the fiscal cliff, uncertainty in Europe, just general political uncertainty which has caused people to be less confident about growth. I think it's been weighing very heavily on those markets. There's been a -- as we've said before, a lot of dialogue, a lot of companies talking to each other, but CEOs are all hesitant to pull the trigger until they get a little more clarity. And I think, if you saw some clarity, I think you could see a pretty big uptick in volumes.

Operator

And gentlemen, at this time, there are no further questions. Do you have any closing remarks?

Dane Holmes

Yes. We'd just like to thank everyone for joining us on our Third Quarter 2012 Earnings Conference Call. If you have any questions, please feel free to contact us at the investor relations department. Otherwise, enjoy the rest of your day.