Operator

Good morning. My name is Rachel, and I will be your conference facilitator today. I would like to welcome everyone to the Goldman Sachs Third Quarter 2010 Earnings Conference Call. After the speakers' remarks, there will be a question-and-answer period. Also, this call is being recorded today, Tuesday, October 19, 2010. Thank you.

Dane Holmes

Thank you, Rachel. Good morning, everyone. 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 fiscal year ended December 2009.

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 and the impact of Basel III 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 Viniar

Thanks Dane. I'd like to thank all of you for listening today. I'll give a brief overview of our third quarter results and then take your questions. Third quarter net revenues were $8.9 billion. Net earnings were $1.9 billion and earnings per diluted share were $2.98. Our annualized return on common equity was 10.3%.

Our performance in the third quarter resulted in a year-to-date annualized return on common equity of 13.2%, excluding the impact of the U.K. bank payroll tax and SEC settlement. Our book value per share has grown 8% to $127.08 year-to-date.

Many of the market concerns that were most prevalent in the second quarter of 2010 continued into the third quarter, with our client base remaining focused on the macroeconomic outlook, particularly in the United States and Western Europe. Markets were also focused on the implications of global financial regulation, specifically implementation of Dodd-Frank Act and Basel III.

Consequently, investment conviction among institutional asset managers remains low, and while CEO confidence seems to be improving, it remains fragile. These factors, combined with the seasonal dynamics of the third quarter, negatively impacted activity levels within many of our businesses.

While we experienced modest improvement in activity levels in September, third quarter activity levels for many of our businesses were at or below second quarter levels. For example, NYSE, NASDAQ and LSE average daily share volumes declined significantly compared with the second quarter, down 27%, 20% and 18%, respectively.

On September 12, the Basel Committee on Banking Supervision announced its capital framework generally referred to as Basel III. This announcement represented an important step in providing greater clarity on global regulatory capital requirements. Ultimately, the Board of Governors of the Federal Reserve System will determine how the capital framework will be implemented for financial institutions in the United States. Understandably, our shareholders have been interested in how this development could impact our business.

While there are many aspects of Basel III that still require rule-writing and many rules that require significant guidance and interpretation, we wanted to provide our best estimate of our position on the Basel III with the caveat that these numbers and assumptions could and almost certainly will change.

At the end of the third quarter, we had a Basel I, Tier 1capital ratio of 15.7%, and a Tier 1 common ratio of 13%. We estimate that our current robust capitalization positions the firm to exceed requirements under the Basel III framework.

If we calculate Basel III requirements with actual second quarter numbers as of June 30, 2010, our estimated Tier 1 common ratio would be nearly 8.8% before considering any mitigating actions. This assumes risk-weighted assets of approximately $750 billion and Tier 1 common of approximately $59 billion. The principal drivers of the increase in total risk-weighted assets are higher credit risk-weighted assets for private equity investments in DVA and higher market risk-weighted rated assets for securitization and correlation risk exposures.

If we assume contractual roll off of our correlation portfolio, expected duration of our mortgage securitization book, coupled with 2.5 years of forward earnings at the 2010 consensus estimates, our Tier 1 common ratio would increase to 11% by the end of 2012. Of course there are many additional steps that we can and will take to further increase our capital ratios.

We also continue to maintain significant excess liquidity, which average $173 billion during the third quarter. While we are awaiting more clarity on rules for the liquidity coverage ratio under Basel III, the concept is very similar to how we manage liquidity with our Global Core Excess and internal liquidity model. We estimate that our current Global Core Excess will comfortably exceed requirements under the new rule set.

Another area of investor focus has been the procedural concerns associated with foreclosure affidavits. In December 2007, we acquired Litton Loan Servicing, a subprime loan servicer. Litton is well known for providing borrowers with alternatives to foreclosure, particularly modifications.

Since 2008, Litton has completed over 80,000 permanent loan modifications. Additionally, approximately one out of every four loans currently serviced has been modified. In the states where the foreclosure process has been suspended Litton currently has approximately 23,000 loans in the foreclosure process. Litton's initiated an extensive review of it's foreclosure procedures, while certain process issues are identified as part of the review to date Litton believes the underlying foreclosure decisions were warranted. I'll now review each of our businesses.

Investment banking produced revenues of $1.1 billion, up 22% from the second quarter. Third quarter advisor revenues were $496 million, up 5% from the second quarter. Goldman Sachs ranked first in the announced and completed M&A globally to date and advise – year to date and advised on a number of important transactions that were announced during the third quarter. These include GDF SUEZ's $21.5 billion transactions in international power, Intel $7.7 billion acquisition of McAfee and Dynegy's $4.7 billion sales for Blackstone.

We were also advisors in a number of significant completed transactions including Novartis's $28.4 billion acquisition of the stake in Alcon, Schlumberger's $11 billion acquisition of Smith International and Millipore's $7 billion sale for Merck. Third quarter underwriting net revenues were $623 million. Equity underwriting revenues are up 30% from the second quarter to $288 million driven by stronger client activity particularly in Asia.

Goldman Sachs ranked first year to date in common stock offerings globally. Debt underwriting was 50% to $355 million. This primary issuance is robust across both leverage finance and investment grade markets.

During the third quarter, we participated in many note worthy underwriting transactions. Including, Agricultural Bank of China's $22.1 billion initial public offering, Impax Corporation $6.2 billion following offering and Valeant Pharmaceuticals combined $1.2 billion high-yield notes offering and $1.6 billion term loan.

Our investment banking backload was flat with the second quarter.

Let me now turn to trading in principle investments, which is comprised of fixed equities and principles investments. Net revenues were $6.4 billion in the third quarter and includes CVA losses of approximately $200 million associated with the tightening of credit spreads on our own debt mostly in debt. [Sick net] revenues were $3.8 billion in the quarter, down 14% from the second quarter. During the third quarter continued macro-economic certainties acerbated seasonally slow customer activity levels and drove weaker sequential revenues across interest rates, mortgages and commodities.

Currency revenues were up modestly from the second quarter levels. Our credit business improved sequentially as a strong issuance calendar and technical support from solid flows into fixed income funds provided a favorable backdrop. Turning to equities, net revenues from the third quarter were $1.9 billion, up 53% sequentially. Equities trading net revenues of $1.1 billion represented a significant improvement compared to the second quarter and reflected a more normalized contribution from our derivatives franchise.

Equities commissions were down 18% to $806 million reflecting lower client activity levels during the quarter. During to risk, average daily value at risk in the third quarter was $121 million, down 11% from the second quarter on lower volatility and continued low activity levels. Let me now review principal investments which produced net revenues of $754 million in the third quarter. Our principal investing portfolio generated net gains of $613 million, largely on corporate public equity investments. We also benefited from overrides of $132 million that were principally driven to $2.25 billion partial sale of the investment of ICBC during the quarter.

In asset management and security services we reported third quarter net revenues of $1.4 billion, up 2% from the second quarter. Asset management produced net revenues of $1 billion, up 5% from the second quarter. Asset management increased $21 billion sequentially to $823 billion, driven largely by market appreciation, partially offset by money market and equity outflows. Security services produced net revenues of $383 million, down 4% from the seasonally stronger second quarter.

Now let me turn to expenses. Compensation benefits expense which is a reminder, include, salaries, bonuses, amortization of prior equity awards and other items was accrued at a compensation net revenues ration of 43%. [Indiscernible] the first two quarters of 2010 and our lowest nine month ratio as a public company. Third quarter non-compensation expenses decreased 24% sequentially, $2.3 billion, primarily driven by the SEC settlement that was included in the second quarter results.

Total staff at the end of the third quarter was approximately $35,400, up 45 from the second quarter, reflecting the normal seasonal pattern of new college and business school starting in the summer. In keeping with the firm's long-standing policy of repurchasing shares. The offset increased in share account over time resulting from employee share-based compensation. We repurchased 5.4 million shares of common stock during the third quarter for a total cost of approximately $800 million.

Even after the share repurchase common shareholders equity increased almost $2 billion during the quarter to $68.7 billion. The operating environment during the third quarter was denominated by heightened uncertainties surrounding the global economic outlook, which contributed to lower activity levels across our global client base. As you know our ability to generate revenues and return to our shareholders is dependent on our clients transacting in the market place, whether it’s a CEO who wants to expand to an acquisition or a portfolio manager deciding to allocate capital to different investment strategies the opportunity for our firm begins with the client's decision to act.

While we've seen some modestly positive signs in recent weeks, it's difficult to predict the catalyst for improved client activity especially since human psychology can be an important driver. However, we believe that it's critical to remain focused on serving our clients and executing our strategy. We believe that these efforts will ultimately drive the strength of our franchise and the value that it can generate for investors over the longer term. 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 Guy Moszkowski with Bank of America, Merrill Lynch.

Guy Moszkowski - Bank of America Merrill Lynch

Good morning, David.

David Viniar

Morning, Guy.

Guy Moszkowski - Bank of America Merrill Lynch

I just wanted to go back to your comments on Basel III and obviously I know it's very preliminary as you said. First of all, can you just give us a sense for what your asset growth assumptions are underlying the runoff of the asset classes that you alluded to?

David Viniar

It's in the numbers that we gave and I'm glad you mentioned what you did, Guy because I gave a lot of caveats about how preliminary these numbers are so I just want to emphasize that. All we did was take our assets as they stand now with no growth of any kind and we took earnings for, as I said we just took 2010 consensus and we assumed that that's what their earnings are going to be for the next two and a half years and then we just assumed contractual roll offs of the correlation book and basically the ratio rate in roll off of mortgage and securitization but no acts of mitigation, no growth, no decline, just those assumptions, made no other adjustments. That's ...

Guy Moszkowski - Bank of America Merrill Lynch

Right, so you also assumed no return of capital other than the existing dividend is that fair?

David Viniar

We assume no return of capital. We assume no equity based compensation that would grow it. We – only the three assumptions mentioned, those are the only changes that we put in to that 11% number.

Guy Moszkowski - Bank of America Merrill Lynch

And since you mention that you chance didn't do any – in this exercise you didn't do any active mitigation can you give us a sense for what types of active mitigation you might consider?

David Viniar

Sure, let me, let me give you just a couple of quick things that could help. For example, we didn’t assume that we made any attempt to reduce the correlation book through tariffs with other dealers. We didn’t assume the same thing with mortgage securitizations. We didn’t assume that any of the – we have a few assets that are subtractions from our capital because they're intangibles that we can probably sale and probably will sale over time. We didn’t assume that. We didn’t assume any roll offs of our principal investment portfolio either just from things being sold or from attempts to sell them. Just a few of the things that come to mind quickly. We didn’t make any of those assumptions at all.

Guy Moszkowski - Bank of America Merrill Lynch

That’s helpful and then just a final question on this topic. From what you can see right now, how might the implementation of Basel III impact your traditional approach to capital management if at all?

David Viniar

Well, I don’t think it's going to approach our – it's going to change our approach to capital management but you know there are some businesses that you know like the ones I mentioned like correlation and securitization businesses that you know given the very, very high, high capital charges might be diminished. Now none of those you know have been that big for us over time but they still would sit and certainly we would probably do less of them.

Guy Moszkowski - Bank of America Merrill Lynch

All right and then just to follow up you mentioned you – you obviously mentioned that Dodd-Frank in your remarks and the uncertainty that that has created. Can you give us any update as to what changes you might be making either strategically or tactically to address some of the elements of Dodd-Frank such as [Indiscernible] or changes in derivatives?

David Viniar

Well it's too early on some of the things because as you know certainly on derivatives most of the rules are not written yet, we're still you know working on that. There are some things that have been pretty public I mean it's been written and its accurate that you know are GSPS business which is the one you know [Indiscernible] our trade business essentially wound down. So that's the one thing and the other things we're waiting to see how the rules unfold.

Guy Moszkowski - Bank of America Merrill Lynch

And final question, just as a follow up to that, how do you see it potentially effecting the special situation?

David Viniar

Again, we're waiting to see how those rules, rules unfold but the predominate part of that business is a business that is actually a lending business, which we think is not only okay under the rules but is actually that this encourage because it you know obviously helps the economy grow.

Guy Moszkowski - Bank of America Merrill Lynch

Fair enough. Thanks very much, David.

David Viniar

You're welcome, Guy.

Operator

Your next question comes from Howard Chen with Credit Suisse.

Howard Chen – Credit Suisse

Good morning, David.

David Viniar

Good morning, Howard.

Howard Chen – Credit Suisse

Appreciate you taking a crack at the Basel III impact. Just a follow up on the mitigation efforts whether its runoff or active mitigation how do you think about the P&L impact and maybe the current ROA of those businesses or portfolios that might be running off or shedding?

David Viniar

Well again, it’s a little hard to tell and again, the caveats of all of the numbers are very preliminary but the businesses that we've talked about have not been that big in the context of the firm. You know it hasn’t been – none of the things we've talked about are our basic you know client franchise trading business that are really the [Indiscernible] and so you know that you know is very hard to estimate will there be any material change from that but we don't know yet. We're going to have to wait and see.

Howard Chen – Credit Suisse

Okay and then just in your mind set, David, you know that not bigger material is 5% -- a ball park range for them?

David Viniar

You're being more prescriptive than I would try to be but I wouldn't dispute those numbers.

Howard Chen – Credit Suisse

Okay and then even with the whatever buffers come down the path, 11% again with all the caveats and the assumptions seems like a very strong and health level capital you know when would you and the mentoring team feel comfortable ramping up the share repurchase to maybe do more than just offset the recent share issuance?

David Viniar

Well our first hope would be that we don't and that we see tremendous opportunities out there which give an ability to use our capital to you know produce returns. So that would be first – our first goal would be to do it that way plus give it back but if we don't then you know over the next several years we would certainly consider giving back more capital to the shareholders.

Howard Chen – Credit Suisse

Great and then you know I guess, finally, David, I think you know just thinking about the summer environment and the record levels you've been underwriting we see and I know historically you know just to paraphrase maybe the management team has stated maybe in certain times not – that it doesn't make sense to be a Top III underwriter and just given where we are in the world today, these extended Euro rates, etc. The liquidity that's out there. Does the view change at all you know just given that with respect to where you want to be as a debt underwriter globally?

David Viniar

Look debt underwriting as you know that's investment grade debt underwriting is not the highest of margin of businesses we have. It's an important business to the firm. We would like to be a leader in that business. Again, a lot of that business is based to some extent on using a balance sheet and we're not going to be a leader in that. So I think the chances that you would see us be a Top III investment grade debt underwriter are not high but we always want to be a major player because it's important for our clients and so we're going to be a you know we're going to be one of the leaders but probably not one of the Top III in the lead [Indiscernible].

Howard Chen – Credit Suisse

And maybe just a quick follow up with that, David, it doesn't – you know looking at who's reported of your peers to date it doesn't feel like you've given up any share or relative revenue share on, on stiff trading but how do you think you know that positioning in debt underwriting changes your relative stance with respect to kind of the fixed trading environment in the credit sub-cluster?

David Viniar

I think it has a very little effect. We're a big enough player there, and I think our willingness to commit our capital on behalf of our clients, help them with their risk management, I think is a much bigger factor.

Howard Chen – Credit Suisse

Great. Thanks so much for taking all the questions.

David Viniar

You're welcome

Operator

Your next question comes from Glenn Schorr with Nomura.

Glenn Schorr – Nomura

Hi, thanks Dave. So, you guys were never a huge originator, but given all the attention on mortgage put-back risk and all the related issues, can you just may be frame how you see Goldman's position in the food chain and maybe any experience you have had so far?

David Viniar

I know you have heard this from others but– I would again give a caveat that it's a very fluid and evolving situation, but we really are pretty small. As you know mortgages while important to Goldman Sachs has always been the smallest of our fixed businesses, never a very large business. To put it in context in the origination, I mean we had a tiny underwriter.

I looked at the statistics, the 40th largest underwriter from 2005, 2008, I am sorry, 40th largest originator, originated $30 billion of loans over that period of time and we originated $1.75 billion. So, we're really tiny in the market, and that drove us to not be one of the leaders in underwriting either. I mean, we were an underwriter, we did it, we are a player in the market, but we are just not one of the leading players.

So, while it's something we continue to watch, and if you've heard from others, there hasn't been that much experience at some parts of it yet. We just don't view our exposures there as being large in the context of the market.

Glenn Schorr – Nomura

Switching gears, just a numbers thing, the staff at period end, and I know that's employees, consultants and temp staff, and I hear you on the 4% seasonal pickup, but it's up 12% year-on-year. It's a little bit of a of head scratcher considering the environment of what's happened with revs, can you give a little color on where that has taken place?

David Viniar

Sure. I think what I'll tell you is a fair amount of it on a percentage basis is outside the United States, where as you know is where we've targeted a lot of our growth. Also, a lot on the risk management side and the control side of the firm, as we get on some of the new regulatory environment. So, we thought that that was appropriate. As you said, the 4% this quarter was -- probably 80% was campus hiring. So, that's really to be expected, but that was really the – the areas of growth were some of the place we've talked about initially, outside the U.S., control and our investment management division.

Glenn Schorr – Nomura

I just want to touch on something that you said, in terms of the netting out of contracts with other broker-dealers that are going to be facing the same increase in risk-weighted assets, to me that seems like an incredibly real and logical place for everyone to go play, and there 's got to be places where we owe you 80 bucks and they owe you 80 bucks and you net things out. How real is that on the active mitigation front? It gets thrown into one liner, but it seems like a big deal?

David Viniar

Again, as I mentioned, we assumed none of it in the numbers that I gave you. But is it real, it should be real. It's complicated because every one of these transactions individually is different, so to pair them off, you have to make sure that you are not accidentally increasing your risk by doing it, but it's something that should be able to happen over time.

Glenn Schorr – Nomura

Is that process full force right now? You have people behind the scenes, some of that increased headcount looking at this exclusively?

David Viniar

I think there is some of it going on, but there is still – people are still interpreting the rules as they go forward to mitigate some of the issues.

Glenn Schorr – Nomura

Alright, cool. Thank you Dave

David Viniar

You're welcome

Operator

Your next question comes from Michael Carrier with Deutsche Bank.

Michael Carrier - Deutsche Bank

Thanks David

David Viniar

Good morning

Michael Carrier - Deutsche Bank

Just one more question on the Basel III. If we think that we get the disclosure from Basel in November and then based on the clarity that you've given now, from the clarity from the Fed for a timeframe, when would you expect to be in a fairly good position where you can now just do the buybacks to offset dilution or you can start looking for opportunities in the market and redeploying the capital?

David Viniar

Well, I am not one who is going to try to anticipate when our regulators might act. So, what they do is completely up to them. But as I said before, our hope is that we're not giving capital back. Our hope is that we're finding opportunities to use it, and if we can't I would suspect as these rules get more and more clarified over the next several years we would be in a position to give more capital back. It's hard to pin down an exact date though.

Michael Carrier - Deutsche Bank

Then on the OTC side, obviously, still have a lot of rulemaking to be done there, but when you look at the likely changes, do you see, and a lot of firms are not, but like a technology driven opportunity for clearing like you guys developed in the equities business for GMA? What would you expect the capital and risk weighted asset benefits to be from using a clearing house versus having trade bilateral on the balance sheet? Finally, just based on the rules under consideration, are there a few of them out there that you are focused on in terms of that could be harmful to the market or to the liquidity in the markets?

David Viniar

Again, it's very hard for me to give you exact numbers on what capital might be freed up. As I mentioned, we didn't assume any capital being freed up in the numbers that I gave, but as things do move to the central clearing and central exchanges, there should be some opportunities for capital being freed up, but it's very hard for us to quantify so I just didn't assume any of that in the numbers I gave you. That will be just an additional benefit. I guess as far as the rules, we're focused on – the things that affect us are the whole question of derivatives and all the various parts of it. The Volker rule and how that's interpreted and how market making is ultimately interpreted and those are probably the biggest things we are looking at.

Michael Carrier - Deutsche Bank

Okay, and then the last one, smaller business, but on the asset management side, you still have like about 5% decay rate on the outflows, mostly on equities and the industry has been challenged there. But just given your weighting more on the institutional side, I guess from a allocation perspective are you seeing any change there and is there anything – issue in terms of performance, you've had a little bit of turnover, just more of the outlook on that business?

David Viniar

What you've seen with us is you've seen the outflow from equities, which you have just seen across the entire industry, we said a slight inflow into fixed income, which is what you've seen. We had some more money market outflows. I think that's partially because we have a somewhat more conservative credit posture in our money market business and when you do that, and it costs you a few basis points and money markets are only returning a few basis points, it's a bigger percentage. So, we are okay with that, because we think that conservative credit view is warranted. So, I think it's really just more industry dynamics than anything else at this point.

Michael Carrier - Deutsche Bank

Okay, thanks a lot.

Operator

Your next question comes from Ed Najarian with ISI Group.

Ed Najarian - ISI Group

Good morning. I just actually had a quick question on some of the numbers you threw out around Basel III. Correct me if I am wrong, but I think you said that if you adjusted your Tier 1 common ratio at the end of the second quarter to a Basel III basis, you'd be at 8.8%?

David Viniar

No, that might have been the way it came out, because I started a little low but I said nearly 8%.

Ed Najarian - ISI Group

Okay, that works. Thank you

Operator

Your next question comes from Roger Freeman with Barclays Capital.

Roger Freeman - Barclays Capital

Hey, good morning David

David Viniar

Good morning Roger

Roger Freeman - Barclays Capital

So, I guess you commented on one of Howard's question, you have a reason to deploy capital really rather than buyback stock, which obviously would be ideal, but then I am kind of tying back to your liquidity levels and you're running at basically the levels you were during the height of the credit crisis. And I am wondering, is that a function of that there isn't; an outlet to deploy that capital today, or that more a function of just where you think best state is to be invested right now, particularly given that rates have been coming in?

David Viniar

I would say it is a combination of the two, but probably a little bit more of the former. We are running really higher than at the height of the credit crisis right now. I think we'd want it to be high. I mean the world is still not a very safe place. There are issues out there. There's uncertain economic outlook in many places. So, we want to be running a higher than normal liquidity reserve, but one of the reasons it is high as it is, is there is just no call on it right now. The same reason our risk is so low and our balance sheet really hasn't grown, there has just been no call on it because there has been very, very little activity from our clients.

Roger Freeman - Barclays Capital

I guess, just a follow-up on Volcker, so for GSPS gets rundown, your defending (NYSEARCA:FSG) the direct corporate equity and real estate investments, it seems like those are probably okay as well. Obviously, they're not addressed by the short-term trading rules, is that fair to say?

David Viniar

I think we're just waiting to see what the final rules say.

Roger Freeman - Barclays Capital

I had thought that maybe the challenge there would be the Basel rules, applying a higher RWA, but it sounds like you kind of come out so well on the pro forma (calyx) that that probably would not be a driver if you're thinking, right?

David Viniar

At it does is, it affects the returns. You have to make sure that – that whatever you do, given what's capital charges are have high enough returns, and if it does then we'll continue to do business and if not then we won't.

Roger Freeman - Barclays Capital

Compensation, you're running 43% year-to-date, fair to assume that that's a reasonable full year run rate.

David Viniar

It's fair to assume that it's a reasonable three quarters run rate.

Roger Freeman - Barclays Capital

Equity trading, can you quantify how much the vol short impact was because there is a such a discrepancy even relative to I think what people thought the impact was like $300 million or $400 million given that commissions were down, and you were up like $600 million or $700 million.

David Viniar

I'm not going to give you exact numbers, but suffice to say and I think I said it last quarter, the biggest diver of what's going on is activity levels, not the tick-up in vol last quarter and the tick-down. That had some effect on it. But while it recovered this quarter you can see that by historical measures, it still wasn't a great quarter. It's fine.

It was good given what you saw available in the market, but if you think of – I don't want to say normal activity levels. I don't think any of these is normal. If you think of historical actively level and historical performance in equities trading, it still wasn't such a great quarter. So, while the vol trading had something to do -- the movement had something to do that, it just wasn't as material as people think it was.

Roger Freeman - Barclays Capital

Okay, but the quarter-to-quarter swing relative to the 17% decline in commissions, if you blackout vol, it sounds like there's still not going to be a lot of consistency between those numbers.

David Viniar

I am sorry. I missed the end of your question.

Roger Freeman - Barclays Capital

It just sounds like, there's still, relative to the activity levels and what you saw on the commissions that there still seems to be somewhat of a disconnect?

David Viniar

Again, you've seen this over time, you've seen there be a disconnect between commissions and equities trading because commission just, plain vanilla share purchases was – trading is driven much more by corporate activity and when they want to risk manage. You saw slight pick-up and I don't want to overstate this at all, a slight pick-up in that activity in September, which was helpful. That's really what drove the change, as well as some impact of the difference in vol trading.

Roger Freeman - Barclays Capital

Okay, great. Thanks David

David Viniar

You're welcome

Operator

Your next question comes from Jim Mitchell with Buckingham Research.

James Mitchell - Buckingham Research

Good morning, maybe just a quick question on just the risk-weighting issue, I mean, if we looked at your latest disclosure in 3Q '09 on sort of the buckets of risk-weighting between market risk, operational risk, credit risk, your market risk was dramatically higher when we look at the European banks, and there seems to be very large disconnect on the market risk side, and it seems to me based on current disclosures and that is going to persist under Basel III, and as sort of the risk adjusted ratio minimums increase, how much of a worry is that for you, is the absolute capital levels that you're carrying at the same level of assets versus your European counterparts? Does that create some sort of ability for them to under price you on fixed income trading or other businesses?

David Viniar

We are hopeful that there will be international harmonization of rules. We don't know they are going to be, we hope they will be, we hope people don't use regulatory arbitrage. But there has always been some of that out there. It hasn't had a major effect in the past and we will do what; A, our regulators tell us is appropriate; and B, what we think is appropriate for safety and soundness, regardless of what others do.

James Mitchell - Buckingham Research

Sure, I just think as ratios go higher that difference becomes bigger right and that's at some point is kind of a critical mass where it does become an issue, hasn't been, but does become one.

David Viniar

It's hard to predict, but all I can tell you is it hasn't been so far.

James Mitchell - Buckingham Research

One last question on the securitization side. There has been a lot of questioning around the securitization just as a whole. If there is a way to put back the whole securitization, it seems more focused on the issuers, but as an underwriter and as sponsor of securitizations, do you feel that there is any risk there?

David Viniar

As I said at first, it's very fluid, so I don't want to give you a definitive answer and have you say, well you said that, very fluid, but we think most of the risk is as an originator and even as an underwriter our position in markets was just – we were not one of the biggest players. So we don't think our exposure is that big.

James Mitchell - Buckingham Research

Got you. Alright, thanks.

David Viniar

You’re welcome

Operator

your next question comes from Kian Abouhossein with JPMorgan.

Kian Abouhossein - JPMorgan

On Basel 2.5 when the rules are final, I was wondering – and they are coming in at the end of 2011, I was wondering if you can give us also an indication how your Basel 2.5 equity Tier 1 number would look like.

David Viniar

I don't have them separated out to 2.5 and 3 here, but we can certainly get back to you offline and give you those numbers.

Kian Abouhossein - JPMorgan

On Basel III, what do you see as your minimum level of equity Tier I that you think you should be having in your business? What is your view on contingent capital?

David Viniar

You asked several questions, but they are actually several good questions. So the one on what minimum, as you know, when always said and done, the minimum requirement as we know now before any other things are put in is 7% on Tier 1 common. Now, it's a while before that's actually in place, but that's ultimately what it's going to be. There may be things on top of that. We don't know. Exactly where we are going to run if that's the minimum, I can't tell you, but we'll run with the buffer as we always have.

We're never going to run very, very close to the line. That we don't think that will be a prudent way to manage our business. So we will always run with some amount of buffer and it's going to depend on the market environment, earnings, risks and other things. So, we will just have to see that over time. I think as far as contingent capital goes, I think contingent capital, if structured correctly, could be a useful part of people's capital structures, but again we are going to have see what rules are, how it can be structured, what the market reaction is going to be and there is a lot of unanswered questions at this point.

Kian Abouhossein - JPMorgan

On the $59 billion on Basel III equity Tier 1, what is the major negative adjustment, because that's a net number, but I would be quite interested even if in subjective terms what the major negative adjustments are to understand maybe what you could potentially mitigate there?

David Viniar

The single biggest negative adjustment is that cumulative preferred no longer accounts as good Tier 1 capital and we have about $5 billion of that. That's the biggest negative adjustment. Then there's a few other smaller ones that – and that $5 billion, obviously it could be replaced, but it can't be mitigated. Then there's a few other smaller ones having to do with some of the ways different things are calculated, some of which might be mitigateable and some which won't, but that's the biggest one by far.

Kian Abouhossein - JPMorgan

If I may ask one more question, we hear from most banks that want to reduce correlation books/liquid, exposures securitization books, but who's going to be on the other side you think refinancing or buying these assets?

David Viniar

Again, a fair number of the trades are dealers-to-dealers. So, as with -- you can get tear ups amongst a number of dealers which does not necessarily increase risk, but you had a fair amount of balance sheet being used, because it was low capital without a lot of risk being taken. So, I think some number can be rolled off that way. I think the other places there might be private pools of capital out there that don't have similar capital charges and become bigger players in this business. I think that the third piece is, as these things roll off, I think in some cases, they are not going to be replaced.

Kian Abouhossein - JPMorgan

Great. Thank you very much for your answers

David Viniar

You're welcome

Operator

Your next question comes from Mike Mayo with CLSA.

Mike Mayo - CLSA

Good morning.

David Viniar

Good morning Mike

Mike Mayo - CLSA

Just a follow-up on Basel III, so you have $750 billion of risk-weighted assets under Basel III as of the second quarter.

David Viniar

Approximately.

Mike Mayo - CLSA

How low could that go? What are some kind of ranges after you take some mitigation actions?

David Viniar

I think some of these things we talked about on – some of the things just from what I talked about get you down to the $700 million range, and then there is other active mitigations that could take it lower than that.

Mike Mayo - CLSA

When you're saying taking it lower, I mean some other banks have talked about cutting the increase in half. Is that reasonable?

David Viniar

I think that sounds pretty big to me, but I don't want to say we can't. Look, if it were a really slow world and we reduced our balance sheet dramatically, maybe we would, but in a more normal operating environment that would seem like a bigger decrease than I would anticipate.

Mike Mayo - CLSA

Maybe of the $300 billion increase, may be you could cut off $100 billion or so. Is that fair?

David Viniar

We could – with the things I told you, we get down to $700 and maybe we can go lower from there. Past that Mike, I think I'd just be making up numbers, and I don't want to do that.

Mike Mayo - CLSA

Then separately, can you give some sense of linked-quarter revenue trends by region, especially Asia?

David Viniar

I believe and I'll come back to you if what I am telling you is not correct, but I believe that the revenue trends you saw for the overall firm were not all that different by region.

Mike Mayo - CLSA

How much is Asia and non-U.S. in this quarter?

David Viniar

Round numbers, I'll always tell you, be careful quarter-over-quarter, round numbers, U.S. is 55%, non-U.S. is 45%, and Europe is a little bigger than Asia of the non-U.S.

Mike Mayo - CLSA

Then lastly, as far as the trends in the quarter, risk appetite trading, how would you characterize say September versus the prior two months and is that continuing into this quarter or is that falling off?

David Viniar

So here is what I would say with the very, very big caveat that you can't read anything into a month. September was an uptick from July and August, but July and August were really slow. Now, it was modestly better, it wasn't that things were worrying in September. As I said, modestly better September than July and August, and October is continuing for now more or like September, but I really caution you not to read very much into it because it could change quickly.

Mike Mayo - CLSA

Got it. Thank you.

David Viniar

You're welcome

Operator

Your next question comes from Chris Kotowski with Oppenheimer.

Chris Kotowski - Oppenheimer

Most of my question have been asked and answered, but maybe you could flush out a little bit the overseas expansion that you're talking about. Is it more people based or capital based, is it origination or trading, can you flush it out a bit for us?

David Viniar

I think you've heard us say before that we think the biggest growth opportunities, we see as a Firm, are going to be in the growth market. And we think that, as you've heard us say many times before, the most important thing for us is activity and activity tends to go with economic growth. We think there is going to be more growth in the growth markets than in developed markets, not that there won't be growth in developed markets. So, we're growing our headcount and we're committing capital in those markets faster than in the developed markets, and its really for all of our businesses. It's for our investment banking business, our trading business or asset management business, all of them.

Chris Kotowski - Oppenheimer

Okay, thanks.

Operator

Your next question comes from Mark Lane with William Blair and Company.

Mark Lane - William Blair and Company

Good morning. I just had a question – quick one on the backlog. I would have thought with dialog levels up, it seems to be build-in a little bit, that the backlog would have improved sequentially. Have you changed your views in terms of the probability of success on the current pipeline or how you are looking at that?

David Viniar

Backlog, well directionally it can sometimes tell you things. You have to be careful with backlogs, because for example, merger deals always get into backlog, because they take a while, equity deals, IPO would tend to get into backlog, because they take a while, following offerings quite often. Don't get into backlog, because you might get a call in one day and do a block or do an accelerated book build and get done in a couple of days.

Also, between quarters something might come in and out in the same quarter. So, I think it's more of a timing question of accruals versus a one time shift than anything else. I would characterize the investment banking activity as up somewhat from what you have seen, but again the question is if the economy has turndown and more bad news comes out then a lot of equity deals won't get done, a lot of mergers won't happen, but if things stay stable or trend up a little bit then I think you will see a pretty big pick up.

Mark Lane - William Blair and Company

Okay, thanks for that clarification.

David Viniar

You’re welcome

Operator

Your next question comes from Jeff Harte with Sandler O'Neill.

Jeffrey Harte - Sandler O'Neill

Good morning. A couple of things. As we talk about what the outlook will be, you mentioned a lot of things. As far as what to watch, I mean does it really come down to a macro call and watch how the global economy performs and if growth resumes business levels will pick up?

David Viniar

I think if growth resumes and regulation gets clarified, then you should see business start to pick up. Then you should see activity levels start to pick up. Then it is up to us to take advantage of that and to do what our clients need and be able to be there for them and hopefully profit from it.

Jeffrey Harte - Sandler O'Neill

We've seen some more distressed assets, some distressed debt activities in the markets. It seems as though quarter after quarter, we talk about you guys have anything capital to deploy, but prices not necessarily getting low enough. It seems like some of the banks are starting to be some sellers of distressed portfolios, do you have a feel for whether offers are coming down versus bids going up and how you're kind of looking at distressed opportunities?

David Viniar

I think you're seeing both of those things. I think offers are coming down and bids are going up. We've seen a few more deals than we've seen in the past, but they're – so far we haven't seen very – we haven't seen a material amount that we thought met our return hurdles. But you're seeing a little bit more activity than you've seen. So, there are possibilities that more of those will happen. There are also possibilities that more will happen at prices that we don't think give us the return hurdle, and so it won't be something that's major for us. We just don't know yet.

Jeffrey Harte - Sandler O'Neill

Finally, this has been hit on but I want to make sure I got it correctly. When it comes to kind of the put back, the rep and warranty type stuff, I mean, certainly your role as a mortgage originator was small. The role in securitizing or mortgage CDOs was bigger, still smaller than most but bigger. It sounds as though you're saying from a securitizer of mortgage CDOs, where you weren't the underlying asset originator there is not a whole lot of risk of things coming back to you. Am I putting words into your mouth?

David Viniar

Yes. What I said was we weren't that big. In the context to the market, we weren't that big. The situation is fluid. There's a not a lot we've seen so far that causes us to think we're going to have that much exposure. But it's very fluid and we don't know yet.

Jeffrey Harte - Sandler O'Neill

Okay, thanks

David Viniar

You're welcome

Operator

Your next question comes from Douglas Sipkin with Ticonderoga.

Douglas Sipkin - Ticonderoga

Thank you and good morning David. Just two questions, one, obviously the backlog is flat. Maybe from a geographical standpoint I was just curious; we've seen a little bit of life just a touch of life in Europe in terms of secondary equities. Just curious if you guys expect to see more of a pickup there with a couple of institutions getting ahead of some of these regulatory requirements, and then secondly, I know you guys have talked about the low rate environment impacting returns. Is there sort of like a – obviously a steep curve but a magic type of level where you'll like to see the tenure at where you think it's optimal for you guys?

David Viniar

On your first question, it's very hard for me to predict what companies are going to do, and obviously, if I knew I couldn't tell you. So it's very hard to answer that question. Where we've seen the most pick-up over the last several months has been Asia. I mean, you've seen more deals coming out of Asia than anywhere and it's not a surprise given the growth trajectory there.

It's very hard to give you a magic number of the tenure rate. As you've heard me say before, the real key is for growth to pick up again. Obviously, as rates continues to come down, it tends to imply that growth is forward, not higher, so slightly higher rates would be better not because of its higher rates, but because it probably means that you've seen more growth and I believe it's more activity.

Douglas Sipkin - Ticonderoga

But just to come back to the first question, and I probably know the answer, if there were activity sort of like a secondary, it's really possible, it's not even in the backlog right now because it's something that sort of comes together quicker? I am not asking you to comment on anything specific, but I am just trying to understand the dynamics of the way you guys calculate the backlog?

David Viniar

No, that's absolutely correct. European bank could decide on Wednesday that they want to do a writes offering and they want to announce it on Friday, again it wouldn't go into backlog. We talk to them, hopefully it would be one of the leaves where they could announce they want to do an accelerate book build and do it the next day, so that might never get into the backlog.

Douglas Sipkin - Ticonderoga

Okay, great. Thanks for taking my questions.

David Viniar

You're welcome

Operator

Your next question comes from Matthew Burnell with Wells Fargo Securities.

Matthew Burnell - Wells Fargo Securities

Good morning. Most of my questions have been asked and answered. I just have a couple of clarifications. David when you were going through the pro forma Basel III capital ratios, the $59 billion number that you quoted, that's Tier 1 common, correct?

David Viniar

Tier 1 common, that's correct.

Matthew Burnell - Wells Fargo Securities

Okay, and then the modest DVA number in the quarter was 200 million across both equity and debt, but largely in FICC?

David Viniar

That's correct.

Matthew Burnell - Wells Fargo Securities

Okay, thanks very much.

David Viniar

You’re welcome

Operator

Your next question comes from Steve Stelmach with FBR Capital Markets.

Steve Stelmach - FBR Capital Markets

Good morning. You just mentioned Asia and it looks by some accounts that China actually may have more equity capital raised in China than U.S for the first time I believe this year, [Indiscernible]. Do you think – and you also have leading share there, do you think you are – equity sides, so the opportunity there or are you and everyone else are just trying to catch up to the opportunity?

David Viniar

I think what you said is absolutely correct. If you look at the trends there is a chance that will happen. We've been talking about that being a big opportunity for long time. We think we have a pretty big competitive advantage there. We've been there for longer. We have a bigger presence than others. We'd like to be bigger. We're held back by making sure we can build the infrastructure and find the right people and other than that we're growing as fast as we think is prudent.

Steve Stelmach - FBR Capital Markets

And then just putting a final point on global core access, you are carrying on a lot obviously, and you mentioned a little bit of it, but is it simply a functional of client activity and pending regulation or is this also sort of expressing a view of where opportunities are right now versus where you are expecting to be going forward over the next 12 to 18 months?

David Viniar

It's a combination of all of those things, but it's much more the former than the latter.

Steve Stelmach - FBR Capital Markets

Perfect. Thank you very much

David Viniar

You're welcome

Operator

Your next question comes from Richard Staite with Atlantic Equity.

Richard Staite - Atlantic Equity

Have you guys ever considered raising the dividend and if not, why not? My thinking around this is that, going forward if you're proprietary trading drops and your income becomes more stable, are you not in a better position to have a higher payout ratio?

David Viniar

We consider everything. We have generally over time felt that for us and for the types of shareholders that we have, if we were going to choose to return capital, that buying back shares is a better way to give it back to our shareholders, but that's not to say that we wouldn't raise our dividend going forward. There is nothing on the table right now, but we look and consider everything over time.

Richard Staite - Atlantic Equity

Okay, and a second question just in terms of your latest thinking on acquisitions. With [indiscernible] come in Asset Management, would you think there are other businesses you would consider?

David Viniar

Again, we have talked over time. We, as you know, have not made a lot of acquisitions over time. There aren't that many examples of successful acquisitions in the financial services industry and there is many more examples of unsuccessful one. It's hard to combine cultures. It's just a people business. We are not necessarily averse to own. If we found something that made sense we would think about it. We just haven't seen many over time that made sense for us. They might make sense for other people, but given our mix of businesses they haven't made sense for us.

Richard Staite - Atlantic Equity

Okay, great. Thanks.

David Viniar

You’re welcome

Operator

Your next question comes from Carole Berger with Soleil.

Carole Berger - Soleil Securities Group

good morning.

David Viniar

Good morning Carole?

Carole Berger - Soleil Securities Group

How are you David? Sometimes I get a little intense, so I'd like you to help me with this a little bit. When you talk about mitigation in regard to risk-weighted assets for your calculations, is it because there is sort of two ways to structure a transaction for a client, and therefore you might choose a less capital intensive way to do the business or is it because the capital required for some of these assets is so significant, it is no longer really an economic or doesn't meet the kind of hurdle returns you'd like in that business? So could you talk about how you would choose to change [Indiscernible] stuff?

David Viniar

What I was really talking about, it's partially the latter, that the capital requirements are too high, but it's also partially that occasionally you will find that we and others will have assets on our balance sheet. They aren't earning very much, aren't giving a lot of risk, but you might have offsetting assets or offsetting asset mobility a long and a short or a long with someone and a short with someone else, which completely mitigate the risk.

When you put those trades on, you could have tried to just take off the first trade, but it was, maybe saved you a little bit of transaction expenses, maybe it was just easier to just put out an offsetting trade, and the capital charges were low enough that it was fine that you had those on your balance sheets. But you sit here today, and all of a sudden, the capital charges even though they may not have a lot of risk are quite high and you say, well, this doesn't make sense, let's work with counterparties on both sides to just tear up those trades, and you cannot affect risk very much, not affect revenues very much, but affect capital a fair amount.

So, that's really what I mean by more active mitigation. In some cases, you may say there are revenues, but the revenues just aren't worth the capital charges anymore and so that's another way. So it's either of those things really I was talking about.

Carole Berger - Soleil Securities Group

Secondarily, given the fact that you are accruing comp at the lowest rate ever, do you still have the same kind of flexibility going into the fourth quarter that you would normally have?

David Viniar

I think, we've told you every quarter in our history that we accrue at where we think is reasonable at that time, but that the final comp numbers are determined at the end of the year, and it's hard to know until the end of the year where they are going to be. And it's going to be based on our competitive position, our actual earnings, the environment and many other things. So, I can't give you a lot more guidance than that.

Carole Berger - Soleil Securities Group

Thank you

Operator

Your next question comes from Roger Freeman with Barclays Capital.

Roger Freeman - Barclays Capital

Hi David, just a couple of follow-ups. Is the reason that – just kind of go through – again, it's early, but the RWA calc under Basel III, is there a reason it maybe doesn't go down as much as for some of the other banks we have been hearing is just because so much of the higher RWA is charged back on the correlation book around the mortgage businesses. Since that wasn't as big for you, they are just not as much of an opportunity set for you to expand?

David Viniar

It's very hard for me to compare us to others, because I don't know what others have. I have seen headline numbers, but I never know what's in there. So I only know what our numbers are, but I don't know theirs. One possibility is, we do have a somewhat larger principal investment portfolio than others, and so I think some of those have higher risk-weighted assets under the new rules. As I said we have made no assumptions of any of that rolling off even though some of that is going to. So that might be one of the things that would help you to...

Roger Freeman - Barclays Capital

okay, and then just on this netting thing, I missed a little bit of what you said on the last question are you just talking about between dealer and dealer, sort of the capital benefits that you might get from tearing it up, as opposed to say between dealer and buy side?

David Viniar

Yeah.

Roger Freeman - Barclays Capital

Okay, and is there any way to entice the buy side and how much of the split, do you think it's like half and half of the business is dealer versus buy side in terms of the swaps?

David Viniar

I think it's more dealer.

Roger Freeman - Barclays Capital

More dealer?

David Viniar

Yeah.

Roger Freeman - Barclays Capital

Okay. But given that there is no retroactive clearing requirement then there is really nothing you can do to push the buy side?

David Viniar

It's just a question of whether it's attractive enough for them.

Roger Freeman - Barclays Capital

Okay, and then just lastly the FX VaR, so that was the biggest reason you're your VaR coming down and volatility obviously was down, but your revenues were up. Can you just talk a little bit to that dynamic? I guess in the second quarter was -- you were kind along Euros, right I think you had mentioned?

David Viniar

I don't think I mentioned that. I would not have been likely to say that. Again, just nothing specific that I would say of currencies versus anything else other than again lower activity levels, lower volatility across the board.

Roger Freeman - Barclays Capital

But good trading environment I guess, your revenues were up?

David Viniar

Okay. When I say they were up, don't read a lot into that. It wasn't like it was a blowout quarter in any way, shape or form, in any business.

Roger Freeman - Barclays Capital

Okay, great. Thanks

David Viniar

You’re welcome.

Operator

Thank you. I would now like to turn the call back over to management for any final remarks.

Dane Holmes

Thank you everyone for joining. If you have any additional follow-up questions, please feel free to contact us in the Investor Relations department, otherwise, have a nice day.