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Executive Vice President
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**Goldman
Sachs**

March 1, 2010

Mr. Philip N. Angelides
Chairman
Financial Crisis Inquiry Commission
1717 Pennsylvania Avenue, NW
Washington, D.C. 20006-4614

Dear Chairman Angelides:

Many of the questions during the first hearing of the Financial Crisis Inquiry Commission focused on issues with respect to residential mortgage-related products. In light of the Commission's interest in this area, we are submitting this letter in an effort to provide a more comprehensive overview of certain of the issues raised over the course of the hearing.

In this letter, we elaborate on the role Goldman Sachs plays as a market maker, how we manage the risk we assume through that role, especially within the context of residential mortgage-related products, our exposure to the housing market, investors in the market for residential mortgage-related products, the different roles and obligations of underwriters and market makers and the extent of our activities in the residential mortgage-related securitization markets in 2006 and 2007. We also discuss Goldman Sachs' due diligence practices and the disclosures that the firm made to the institutions that considered investing in securities that we underwrote.

Role as a Market Maker

Market makers or financial intermediaries are critical to the efficient functioning of the financial markets: their role is to stand ready to make an offer to buy or sell a given financial instrument whenever a seller or a buyer enters the market. As a market maker, we execute a variety of transactions each day with clients and others, buying and selling financial instruments, which may result in long or short risk exposures to thousands of different instruments at any given time. This does not mean that we know or even think that prices will fall every time we

sell or are short, or rise when we buy or are long. In these cases, we are executing transactions in connection with our role of providing liquidity to markets. Clients come to us as a market maker because of our willingness and ability to commit our capital and to assume market risk. Indeed, during the fourth quarter of 2009, for example, our clients asked us to bid on approximately \$7 billion (face amount) per week of mortgage- and asset-backed securities. Further, our clients typically have relationships with a number of other financial intermediaries and they compare the products, services and pricing offered by such other intermediaries and us prior to determining with whom to transact.

Without market makers that are ready, willing and able to take the other side of a transaction, a liquid market simply cannot exist. That is why financial intermediation is critical to the functioning of the capital markets and, ultimately, the financial system. Financial intermediaries connect buyers and sellers. When a buyer or seller is not readily available, financial intermediaries take the other side of a transaction and assume the risk of the trade on their own books. These transactions often are initiated by our clients, and when proposed by us are often in response to previously expressed investment interests of the client. We are responding to our clients' desire either to establish, or to increase or decrease, their exposure to a position based on their own investment views. We are not "betting against them."

How We Manage Our Risk

Our willingness to take on risk is fundamental to our role as a financial intermediary. The better we understand and can manage that risk, the more willing we are to transact with clients (regardless of our view on the market) and, thereby, to offer them better prices. Our clients expect us to be willing to transact in all market conditions. They often competitively bid positions, and execute with us depending on whether we satisfy their objectives – e.g., pricing, speed and certainty of full execution – better than competing market makers or other financial intermediaries.

The exposures created through transactions with clients are part of the overall "inventory" of instruments we generally carry as part of our business. This inventory is comprised of long and short positions. Its composition reflects the accumulation of customer trades and our judgments about supply and demand or market direction. If a client asks us to transact in an instrument we hold in inventory, we may be able to give the client a better price than it could find elsewhere in the market and to execute the order without potential delay and price movement. This inventory represents a risk position that we manage continuously.

In so doing, we must also manage the size of our inventory and keep exposures in line with risk limits. We believe that risk limits are an important tool in managing our firm. They are established by senior management, and scaled to be in line with our financial resources (capital, liquidity, etc.). They help ensure that regardless of the opinions of an individual or business unit about market direction, our risk remains within prescribed levels.

In addition to selling positions, we use other techniques to manage risk. These include establishing offsetting positions ("hedges") through the same or other instruments, which serve to reduce the firm's overall exposure. Hedges, however, may give rise to other risks. For example, the use of credit default swaps as hedges in turn results in a new credit risk: the ability of the writer of the credit default swap to perform on the obligation. In order to manage this risk,

Goldman Sachs generally requires the writer of the credit default swap to post cash collateral against its obligations to the firm, or may structure other risk mitigants.

In this way, we are able to serve our clients and to maintain a robust client franchise while prudently limiting overall risk consistent with our financial resources.

Goldman Sachs' Exposure to, and Results from Business Relating to, the Residential Housing Market

With that background, we want to outline for you Goldman Sachs' exposure to, and results from business relating to, the residential housing market. While this has been the subject of much recent attention, it has always been a very small part of our overall business. For example, during the period 2003 to 2008, the firm's annual net revenues attributable to residential mortgage-related products never exceeded 2% of our overall net revenues. Through the end of 2006, Goldman Sachs generally was long in exposure to residential mortgages and mortgage-related products, such as residential mortgage-backed securities ("RMBS"), collateralized debt obligations ("CDOs") backed by residential mortgages and credit default swaps referencing residential mortgage products. In late 2006, we began to experience losses in our daily residential mortgage-related products P&L as we marked down the value of our inventory of various residential mortgage-related products to reflect lower market prices.

In response to those losses, we decided to reduce our overall exposure to the residential housing market. We wanted to get "closer to home" – i.e., to reduce our overall exposure to the residential housing market, consistent with our risk protocols – given the uncertainty of the future direction of the housing market and the increased volatility of mortgage-related product markets. Indeed, we reduced both our short positions and our long positions in these products over the course of 2007. For example, during the first quarter of 2007, we reduced various short positions in light of applicable risk limits even though (viewed in isolation) these positions had been profitable. Overall, our residential mortgage-related product positions had a negligible effect on the firm's net revenues or profits for fiscal year 2007. During fiscal year 2008, we had net losses of approximately \$1.7 billion on residential mortgage-related product positions. As these results demonstrate, the firm did not generate enormous net revenues or profits by betting against residential mortgage-related products, as some have speculated; rather, our relatively early risk reduction resulted in our losing less money than we otherwise would have when the residential housing market began to deteriorate.

Investors in the Market for Residential Mortgage-Related Products in 2007

The markets for residential mortgage-related products, and subprime mortgage securities in particular, were volatile and unpredictable in the first half of 2007. Goldman Sachs had no "inside information" about the residential housing trends or macroeconomic factors that ultimately would drive market values. Investors in these markets held very different views of the future direction of the housing market based on their outlook on factors that were equally available to all market participants, including housing prices, interest rates and personal income and indebtedness data. Some investors, including some hedge funds, developed aggressively negative views on the residential mortgage market. Other investors, including other hedge funds, believed that any weakness in RMBS and the residential housing market would be relatively

mild and temporary. Investors with both sets of views came to Goldman Sachs and other financial intermediaries to establish long and short exposures to the residential housing market, through RMBS, CDOs, credit default swaps and other types of instruments or transactions. We would also note that broadly-disseminated research from Goldman Sachs Economic Research (“Economic Research”), which is independent from other divisions of the firm, expressed consistently negative views on the residential housing market in 2006 and 2007. Indeed, our Economic Research expressed an increasing level of concern about the run up in housing prices in papers dating back to at least 2004. (See Appendix I) Various other firms’ broadly-disseminated research reports from 2006 contained warnings of deteriorating residential housing market conditions.

The investors who transacted with Goldman Sachs in CDOs in 2007, as in prior years, were primarily large, global financial institutions, insurance companies and hedge funds (no pension funds invested in these products, with one exception: a corporate-related pension fund that had long been active in this area made a purchase of less than \$5 million). These investors had significant resources, relationships with multiple financial intermediaries and access to extensive information and research flow, performed their own analysis of the data, formed their own views about trends, and many actively negotiated the structure and terms of transactions.

These investors entered into transactions having certain characteristics in order to achieve their desired long or short exposure. They were aware of and accepted the market risk they were assuming. For securities backed by residential mortgages, the characteristics of the underlying mortgages were disclosed in detail and investors knew what they were buying. The investment views of different participants in these markets depended on their respective assessments of macroeconomic trends, as well as their analysis of the disclosed characteristics of the mortgages. Neither their views on macroeconomic trends nor their analysis of loan characteristics depended on whether Goldman Sachs hedged or retained the initial exposure we took on as a result of the transaction.

It is also important to note that it is not just a belief in the absolute direction of prices but also the relative level of prices that drive investors’ actions. For example, a particular security may trade at a distressed level. The institution holding that asset may nonetheless want to sell the security to remove what it believes is a source of further risk from its balance sheet or to free up capital for other investments. A buyer of that asset believes that the distressed pricing may potentially reflect good value and is willing to take on that risk for a price, even if other investors think otherwise. The process of being able to buy risk from those unwilling or unable to shoulder it is vital to a functioning market and economy.

Residential mortgage-related products issued or underwritten by numerous firms ultimately did not perform as expected because of unprecedented economic developments. Goldman Sachs, as well as the sophisticated investors who invested in these products, certainly did not envision the events that led to such poor performance. With the benefit of hindsight, it is apparent that most participants – including rating agencies, financial institutions and government agencies – put too much faith in historical performance, believing that most residential mortgage assets were highly resilient to downturns. It was clear, however, that many loans with the characteristics disclosed in offering documents for these products would perform poorly in a very rapidly deteriorating housing market and meaningful economic recession, but Goldman

Sachs and most investors simply did not predict or anticipate how severe the contraction in the housing market would become.

Role of an Underwriter

The role of an underwriter differs from that of a market maker. As described above, a market maker is primarily engaged in the business of assisting clients in executing transactions. This business is client-driven, and Goldman Sachs strives to provide a fair price to our clients.

In contrast, an underwriter works with the issuer in connection with offering financial instruments to investors. In this context, the federal securities laws effectively impose a “gatekeeper” role on Goldman Sachs: as an underwriter we are expected to assist the issuer in providing an offering document to investors that discloses all material information relevant to the offering and, absent a showing that we conducted an appropriate review (so-called “due diligence”) regarding the securities being offered, we are potentially liable to investors for any losses resulting from any material misstatements or omissions in the offering document. The same disclosure obligations do not apply to a market maker, including because a market maker must execute countless transactions in order to meet the demands of clients and other parties. If a market maker were required to perform extensive due diligence on each security in which it was asked to execute a transaction, and to update disclosures every time it bought or sold securities, real-time, liquid markets could not exist.

In connection with our underwriting of residential mortgage-related securities, Goldman Sachs had a process in place to examine the management, relevant policies and procedures, underwriting standards, creditworthiness and other aspects of each mortgage originator before the firm began purchasing loans for securitization. As a result of these reviews, we determined not to do business with dozens of originators. Goldman Sachs also emphasized maintaining regular contact with major loan originators to understand the issues that they faced and the steps they were taking to address them. We also employed internal and third-party resources to conduct due diligence on the individual loans in the pools backing the securities in its RMBS offerings, including reviewing selected loan files, verifying compliance with state and federal lending statutes, and selective review of property appraisals against comparable values. As a result of these reviews, Goldman Sachs did not accept loans that, based on its review and analysis, appeared to have potentially significant legal, regulatory compliance or other issues. Knowing what we know today, of course, we wish that we had done even more.

Regardless of the degree of due diligence performed by underwriters in connection with RMBS securitizations, however, they cannot guarantee payment, performance or any rate of return. Rather, it is up to the purchaser of securities to evaluate whether the securities are worthy of investment based on the purchaser’s own view and analysis of the securities’ value in light of the purchaser’s expectations about the future of the housing market and the economy and, importantly, the disclosures set forth in the offering documents including, in the case of asset-backed securities, detailed descriptions of the underlying assets. The Securities and Exchange Commission’s Regulation AB, which provides extensive requirements and guidance for disclosures in offerings of asset-backed securities, properly focuses on disclosure of the material characteristics of the assets on which investors rely for the cash flows that provide the basis for payment of interest and principal on the securities they are purchasing. Those disclosures for

RMBS include detailed statistical information on the loans in the pool backing the RMBS, including the material originators of the loans, borrower credit scores, locations of the properties, loan to value percentages and the type of loans (e.g., second lien, adjustable rate, or option adjustable rate). The disclosures also included detailed descriptions of the policies and procedures used by the material loan originator or originators to evaluate and determine whether to make a loan. (See Appendix II)

In addition, Goldman Sachs, like other underwriters of RMBS, disclosed extensive data on every individual loan in its securitizations through “loan tapes,” and other documents analyzing the underlying loans, which were publicly filed by the issuer with the Securities and Exchange Commission. These documents contained detailed information on each individual loan underlying the securitization, such as: (1) the original term of the loan; (2) the current balance; (3) the applicable interest rate; (4) the type of loan (e.g., adjustable rate or fixed rate); (5) whether the loan was a first or second lien; (6) the original loan-to-value ratio; (7) the property type (e.g., single family home); (8) the borrower’s FICO score; (9) whether the property was owner-occupied; and (10) the due date and delinquency status. This information enabled the sophisticated investors that purchased these instruments to run their own models and make their investment decisions based on their views of relevant macroeconomic factors, market and housing trends, as well as the apparent credit of the borrowers whose mortgages backed the securities. (See Appendix III)

Nationally recognized law and accounting firms also were retained in connection with underwritings to assist in ensuring that the disclosures were complete, accurate and in compliance with the securities laws. These disclosures included numerous risk factors, which highlighted those characteristics of loans that increased risk (such as lower quality credit history, high loan-to-value ratio, and lack of documentation or independent verification). (See Appendix II)

Based on these disclosures, and publicly-available macroeconomic, housing and other data, investors could and did employ sophisticated analysis of the characteristics of the loan pool before deciding whether to invest in the transaction and which types of securities to purchase (from the highly rated senior securities that offered the most protection against deterioration of the asset pool and lowest return, to lower rated securities that offered less protection and a higher return).

In short, the securities being sold were as described – the investors purchased what they knowingly determined to buy. In view of what transpired in the housing market and the economy, the securities performed substantially as would have been expected in those unexpected circumstances. At the time of purchase, however, what participants in this market – including Goldman Sachs – could not know was how the housing market and the economy would perform in the future.

For non-synthetic CDOs – i.e., CDOs collateralized by cash securities – the offering materials contained detailed risk disclosures, and set forth each of the securities in the portfolio at or about the time of closing that determined the cash flows to investors. (See Appendix IV) We provided analyses to investors that highlighted how the securities would perform under certain scenarios and based upon stated assumptions, and these investors often had their own

models to analyze the credit worthiness of the underlying cash securities. Investors then could (and did) refer to those disclosures in making investment decisions. Again, investors had detailed information that allowed them to analyze how the securities would perform under different assumptions and scenarios.

For CDOs containing predominantly or exclusively synthetic assets – i.e., credit default swaps referencing RMBS or CDO securities, rather than the RMBS or CDO securities themselves – one party (the counterparty to the credit default swap) necessarily has to assume a short position with respect to the synthetic assets in order for there to be a long position for investors to take – there was no “secret” short position. As part of our disclosures, we indicated that Goldman Sachs initially would take the short side of the transaction, where applicable. There was no limitation on our ability to sell some or all of the short position. (See Appendix V) The sophisticated institutions that bought CDO securities did not make their decisions based on whether Goldman Sachs or other firms entering into credit default swaps with the CDO issuer would keep or sell that short position; they made their investment decisions based on their fundamental analysis of the characteristics of the underlying referenced assets and their prediction of where the housing market and the economy would be in the future. In fact, Goldman Sachs’ CDOs containing primarily residential mortgage-related synthetic assets were initially created in response to the request of a sophisticated institutional investor that approached the firm specifically seeking that particular exposure. Reverse inquiries from clients were a common feature of this market.

Participation in the Residential Mortgage-Related Securitization Markets

Goldman Sachs has never been a significant originator of mortgages.¹ And, in the context of the overall mortgage markets, we were neither a leading issuer² nor a leading underwriter of securitized residential mortgage-related products. During the period 2002 through 2007, our market shares as an issuer and underwriter of Non-Agency RMBS varied between 1.9% and 4.0% as an issuer and 4.7% and 6.7% as an underwriter.³ In 2007, for example, the firm’s market share as an issuer of Non-Agency RMBS was 3.0% and we were not among the top 10 underwriters of these securities.⁴ For overall RMBS issuance, including agency securities, Goldman Sachs was ranked 12th as an issuer in 2006 with a market share of 2.3% and 18th as an issuer in 2007, with a market share of 1.2%.⁵ Thus, although Goldman Sachs was a participant in the RMBS securitization business, it certainly did not dominate the market as either an issuer or underwriter.

¹ In March 2007, Goldman Sachs acquired Senderra, a small mortgage originator.

² An issuer is the legal entity that owns the pool of residential mortgages or RMBS, CDOs or combination thereof and “issues” securities representing various interests therein. For the purpose of compiling market share data, industry sources treated a firm as the issuer of RMBS if the securities were issued off of one of that firm’s shelf registration statements, even though the issuing entity was often a separate legal entity.

³ Source: *Inside Mortgage Finance*. It was always the case that we were the underwriters of securities that we issued, so all securities issued off of Goldman Sachs’ shelf registration statements would be counted in both categories.

⁴ Source: *Inside Mortgage Finance*. Rankings below the top ten were not published in 2007, so our market share is unavailable. We note, however, that the 10th ranked underwriter had a market share of 5.5%.

⁵ Source: *Inside Mortgage Finance*. *Inside Mortgage Finance* published overall RMBS market share information with respect to issuer participation only and did not publish such information for years prior to 2006.

This point is equally true if one focuses solely on the so-called “subprime” segment of the overall RMBS market. During the period 2002 to 2007, our market shares as an issuer and underwriter of subprime RMBS varied between 0.9% and 4.7% as an issuer and less than 4.2% and 6.5% as an underwriter.⁶ In 2007, for example, the firm’s market share as an issuer was 1.7% (we were ranked 21st) and we were not ranked in the top ten as an underwriter.⁷

Goldman Sachs also was not a dominant participant in new-issue residential mortgage-related CDO activity. During the period 2002 through the first three quarters of 2007 our market share as an underwriter of new-issue CDOs where the collateral consisted primarily of RMBS varied between 2.4% and 8.2%.⁸ For example, Goldman Sachs’ market share in the first three quarters of 2007 was approximately 5.6%.⁹ As discussed above, substantially all CDOs were sold to sophisticated institutions that met the definition of Qualified Institutional Buyers under Securities and Exchange Commission Rule 144A.

Conclusion

Although Goldman Sachs held various positions in residential mortgage-related products in 2007, our short positions were not a “bet against our clients.” Rather, they served to offset our long positions. Our goal was, and is, to be in a position to make markets for our clients while managing our risk within prescribed limits. Our predominant view of the risks arising from the residential housing market in early 2007 caused us to reduce our overall exposure to market movements in either direction consistent with established risk protocols.

We certainly did not know the future of the residential housing market in the first half of 2007 any more than we can predict the future of markets today. We also did not know whether the value of the instruments we sold would increase or decrease. It was well known that housing prices were weakening in early 2007, but no one – including Goldman Sachs – knew whether they would continue to fall or to stabilize at levels where purchasers of residential mortgage-related securities would have received their full interest and principal payments. Finally, we were not consistently or significantly overall net “short the market” in residential mortgage-related products, and, contrary to media speculation, we did not generate enormous net revenues or profits from our residential mortgage-related activities.

⁶ Source: *Inside Mortgage Finance*.

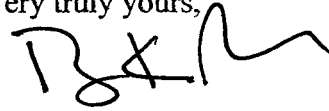
⁷ Source: *Inside Mortgage Finance*. Rankings below the top ten were not published in 2007 so our market share is unavailable. We note, however, that the 10th ranked underwriter had a market share of 4.2%.

⁸ Source: *Asset-Backed Alert*. No CDOs were issued off of Goldman Sachs’ shelf registration statements and therefore issuer information is not applicable.

⁹ Source: *Asset-Backed Alert*. Market share data for the fourth quarter of 2007 is not available.

We hope that the information above is helpful to the continuing work of the Commission.

Very truly yours,

A handwritten signature in black ink, appearing to read 'G. Palm', with a stylized flourish extending to the right.

Gregory K. Palm

cc: Hon. Bill Thomas
(Commission Vice Chairman)

Brooksley Born
(Commissioner)

Byron S. Georgiou
(Commissioner)

Senator Bob Graham
(Commissioner)

Keith Hennessey
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