



BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 5, 2009

Ms. Sarah Smith  
Chief Accounting Officer  
The Goldman Sachs Group, Inc.  
85 Broad Street  
New York, New York 10004

Dear Ms. Smith:

This letter is in response to the requests from The Goldman Sachs Group, Inc. ("GSGI") and Goldman Sachs Bank USA ("Bank"), both of New York, New York, for temporary exemptions from the application of certain aspects of the Board's market risk rules for state member banks and bank holding companies (together, the "Market Risk Rules")<sup>1</sup> and the Board's general risk-based capital rules for bank holding companies (the "Credit Risk Capital Rules").<sup>2</sup>

On September 21, 2008, the Board approved the application by GSGI to become a bank holding company,<sup>3</sup> and on September 25, 2008, the Board approved the application by Bank for membership in the Federal Reserve System.<sup>4</sup> To facilitate the orderly transition of GSGI and Bank to the Board's Market Risk Rules and Credit Risk Capital Rules, GSGI has requested that (1) through December 31, 2009, GSGI and Bank be permitted to use certain Value-at-Risk ("VaR") models approved by the SEC, as supplemented by supervisory add-ons approved by the SEC (together, "SEC-approved models"), to determine their capital requirements for specific risk under the Market Risk Rules; (2) through December 31, 2009, GSGI and Bank be permitted to use methods approved by the SEC to determine their capital requirements under the Market Risk Rules for those trading assets, including distressed debt and restricted stock investments, that the SEC did not require to be included in the VaR-based models of GSGI and Bank; and (3) GSGI be allowed to use methods approved by the SEC to calculate risk-based

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<sup>1</sup> 12 CFR parts 208 and 225, Appendix E.

<sup>2</sup> 12 CFR part 225, Appendices A and F.

<sup>3</sup> The Goldman Sachs Group, Inc., 94 Federal Reserve Bulletin C101 (2008). GSGI was previously subject to the consolidated supervised entity capital requirements established by the U.S. Securities and Exchange Commission ("SEC") and subject to market risk capital requirements similar to the Market Risk Rules. See Appendix E to 17 CFR 240.15c3-1.

<sup>4</sup> Board letter to Michael T. Escue, Esq., dated September 25, 2008.

capital requirements for its nonfinancial equity investments (“merchant banking investments”) that are subject to the Board’s Credit Risk Capital Rules.<sup>5</sup>

### Market Risk Rules Requests

Under the Market Risk Rules, an institution with significant exposure to market risk must maintain adequate capital to support that exposure.<sup>6</sup> In addition to the requirement for an institution subject to the Market Risk Rules to have a VaR model to measure general market risk, the institution also must capture its exposure to idiosyncratic or specific market risk either through a model approved by the Federal Reserve or by applying standard specific risk charges.<sup>7</sup> The Board has authority to provide exemptions from the Market Risk Rules.<sup>8</sup>

With respect to the requests by GSGI and Bank for a transition period to come into full compliance with the Market Risk Rules, the Board concludes that the limited and temporary relief described above would permit GSGI and Bank to complete the transition to the Market Risk Rules in a safe, sound, and orderly manner.

To allow an appropriate amount of time for Federal Reserve staff to conduct in-depth reviews of all relevant market risk models, the Board has decided that GSGI and Bank may use certain SEC-approved models to calculate their risk-based capital requirements for specific risk under the Market Risk Rules, provided that in no case shall GSGI or Bank use the SEC-approved models to calculate any capital requirements under the Market Risk Rules after the December 31, 2009, reporting date. Based on the Board’s preliminary review, the risk-based capital requirements for specific risk produced by the SEC-approved models used by GSGI and Bank appear to be sufficiently conservative for the transition to the Board’s Market Risk Rules. During 2009, Federal Reserve staff will, among other things, review the existing specific risk models of GSGI and Bank on a model-by-model basis. After Federal Reserve staff completes its review of each model, GSGI and Bank may continue to use that model to calculate the specific risk of covered positions under the Market Risk Rules only if GSGI and Bank have demonstrated to the Federal Reserve that the model adequately measures the specific risk of covered positions. If GSGI and Bank have not made such a demonstration, they must begin applying the standard specific risk capital requirements in the Market Risk Rules to

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<sup>5</sup> See 12 CFR part 225, Appendix A, § II.B.5.

<sup>6</sup> 12 CFR parts 208 and 225, Appendix E, § 1(a). Positions covered by the Market Risk Rules (“covered positions”) generally include all assets, liabilities, and off-balance-sheet items in an organization’s trading account, and all foreign exchange and commodity positions both in and outside the trading account. Most covered positions are excluded from the Credit Risk Capital Rules.

<sup>7</sup> See 12 CFR parts 208 and 225, Appendix E, § 5. If an institution has not demonstrated to the Federal Reserve that its model measures the specific risk of covered positions, it must use the standard specific risk capital requirements in the Market Risk Rules.

<sup>8</sup> See 12 CFR parts 208 and 225, Appendix E, § 1(b)(3).

all covered positions that are covered by the model immediately after Federal Reserve staff completes its review of the model.<sup>9</sup>

In addition, GSGI and Bank may continue to use methods approved by the SEC to determine their capital requirements under the Market Risk Rules for those trading assets, including distressed debt and restricted stock investments, that the SEC did not require to be included in the VaR-based models of GSGI and Bank, until the December 31, 2009, reporting date. After that time, all the requirements in the Market Risk Rules will apply to these assets as follows: they must be included in the general VaR of GSGI and Bank, and GSGI and Bank must either have a specific risk model approved by Federal Reserve staff for these investments or apply the standard specific risk capital requirements in the Market Risk Rules to them.

During and after the transition period to full implementation of the Board's Market Risk Rules, GSGI and Bank must maintain the accounting controls surrounding their computation of capital requirements for market risk. These controls are a critical element supporting the reliability of reported capital requirements.<sup>10</sup>

#### Credit Risk Capital Rules Request

For merchant banking investments that are not covered positions, bank holding companies must use the approach described in the Credit Risk Capital Rules to determine the risk-based capital requirements for those investments. Under the Credit Risk Capital Rules, a bank holding company must deduct a percentage of the adjusted carrying value of merchant banking investments from tier 1 capital based on the aggregate percentage of the holding company's tier 1 capital represented by the investments.<sup>11</sup> The Board has broad authority to provide exemptions from the Credit Risk Capital Rules.<sup>12</sup>

GSGI has requested that it be allowed to use the approach approved by the SEC for its merchant banking investments. GSGI has not indicated that it is unable to perform the capital calculations required under the Credit Risk Capital Rules for its merchant banking investments, and the Board believes that the risk-based capital requirements under the Credit Risk Capital Rules are more appropriate for merchant banking

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<sup>9</sup> See 12 CFR parts 208 and 225, Appendix E, § 5.

<sup>10</sup> In addition, GSGI and Bank may not use internal models approved by the SEC to calculate their risk-based capital requirements for counterparty credit risk and instead must use the approach in the Credit Risk Capital Rules to calculate their capital requirements arising from counterparty credit risk. See 12 CFR parts 208 and 225, Appendix A, § III.E. Furthermore, all the qualitative requirements in section 4(b) of the Market Risk Rules will apply immediately to GSGI and Bank's covered positions with capital requirements that are determined based on VaR models. See 12 CFR parts 208 and 225, Appendix E, § 4(b).

<sup>11</sup> See 12 CFR parts 208 and 225, Appendix A, § III.B.5.c.

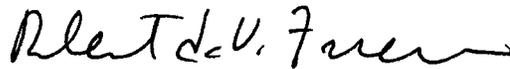
<sup>12</sup> See 12 CFR parts 208 and 225, Appendix A, § III.A.

investments. Granting the request, moreover, would result in inequitable treatment with respect to other bank holding companies that hold similar exposures. Accordingly, the Board declines to grant the relief requested.

These determinations are specifically conditioned on compliance by GSGI and Bank with all the commitments and representations made to the Board in connection with the requests for exemptions. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the requests and, as such, may be enforced in proceedings under applicable law. These determinations are based on the specific facts and circumstances of GSGI and Bank. Any material change in those facts or circumstances or any failure by GSGI and Bank to observe any of their commitments or representations may result in different determinations or in revocation of the exemptions.

Please contact Homer C. Hill, III of the Federal Reserve Bank of New York at (212) 720-2164 if you have any questions.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Robert deV. Frierson". The signature is fluid and cursive, with a long horizontal stroke at the end.

Robert deV. Frierson  
Deputy Secretary of the Board

cc: Homer C. Hill, III  
Federal Reserve Bank of New York