



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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

April 22, 2009

Mr. Michael Civitella
Chief Executive Officer and President
Goldman Sachs Bank USA
295 Chipeta Way, Fourth Floor
Salt Lake City, Utah 84108

Dear Mr. Civitella:

This is in response to your request on behalf of Goldman Sachs Bank USA (“Goldman Bank”), Salt Lake City, Utah, for exemptions from section 23A of the Federal Reserve Act and the Board’s Regulation W¹ and an exception from the anti-tying restrictions in section 106 of the Bank Holding Company Act Amendments of 1970.² Granting these requests would permit Goldman Bank to acquire certain assets and businesses from its parent, Goldman Sachs Group, Inc. (“GSGI”), New York, New York, and certain GSGI nonbank subsidiaries in connection with a proposed internal reorganization.

You have indicated that GSGI proposes to reorganize its business in connection with Goldman Bank’s conversion from an industrial loan company to a state member bank.³ As part of that reorganization, Goldman Bank proposes to acquire certain entities and assets (“Assets”) from GSGI and other affiliates and to extend credit to affiliates secured by the Assets on a transitional basis.

In the reorganization, GSGI will transfer seven of its subsidiaries to the bank, as well as certain other assets, and these entities will become operating

¹ 12 U.S.C. § 371c; 12 CFR part 223.

² 12 U.S.C. § 1971 *et seq.*

³ Goldman Bank’s application for membership in the Federal Reserve System was approved on September 25, 2008.

subsidiaries of the bank. The subsidiaries included in the Assets to be transferred are listed in Appendix A. In addition, the Assets to be acquired by Goldman Bank include:

- Certain loans, unfunded commitments, and securities totaling approximately \$[]; and
- Mortgage servicing rights currently owned by Avelo Mortgage, L.L.C., a GSGI subsidiary.

The Assets may include loans that contain conditions that would have violated the anti-tying restrictions in section 106 if the loans had been extended by a bank.

Section 23A Exemption Requests

Section 23A and Regulation W limit the amount of “covered transactions” between a bank and any single affiliate to 10 percent of the bank’s capital stock and surplus and limit the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank’s capital stock and surplus.⁴ “Covered transactions” include a bank’s purchase of assets from an affiliate, a bank’s extension of credit to an affiliate, the issuance of a guarantee by a bank on behalf of an affiliate, and certain other transactions.⁵ The statute and regulation also require a bank to secure its extensions of credit to, and certain other covered transactions with, affiliates with prescribed amounts of collateral.⁶ In addition, section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate⁷ and require that all covered transactions between a bank and an affiliate be on terms and conditions that are consistent with safe and sound banking practices.⁸

Goldman Bank’s purchase of the Assets from GSGI and the bank’s extensions of credit to affiliates secured by the Assets would be covered transactions subject to the quantitative limits and qualitative requirements of

⁴ 12 U.S.C. § 371c(a)(1) and 12 CFR 223.11 and 223.12.

⁵ 12 U.S.C. § 371c(b)(7) and 12 CFR 223.3(h).

⁶ 12 U.S.C. § 371c(c) and 12 CFR 223.14.

⁷ 12 U.S.C. § 371c(a)(3) and 12 CFR 223.15.

⁸ 12 U.S.C. § 371c(a)(4) and 12 CFR 223.13.

section 23A and Regulation W.⁹ The aggregate value of these covered transactions for purposes of Regulation W would be up to \$[].¹⁰ This amount would exceed the bank's quantitative limits under the statute and rule.

To facilitate the reorganization, Goldman Bank has requested exemptions from section 23A and Regulation W for these covered transactions. Section 23A and Regulation W specifically authorize the Board to exempt, in its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds the exemption to be in the public interest and consistent with the purposes of section 23A.¹¹ The Board previously has indicated that the twin purposes of section 23A are (i) to protect against a depository institution suffering losses in transactions with affiliates; and (ii) to limit the ability of an institution to transfer to its affiliates the subsidy arising from the institution's access to the federal safety net.¹²

A. Asset Purchase Exemption Request

The Board previously has granted to other banks exemptions from section 23A and Regulation W that are similar to the exemptions requested by Goldman Bank. The Board routinely has approved exemptions under section 23A for one-time asset transfers that are part of a corporate reorganization and that are structured to ensure the quality of the transferred assets.¹³ To ensure the quality of the transferred Assets and to protect Goldman Bank, the Board has determined to impose several conditions in connection with this exemption:

- The Assets must be externally rated B- or higher by a nationally registered statistical rating organization ("NSRO") or, if unrated, of

⁹ See 12 U.S.C. § 371c(b)(7)(A) and (C); 12 CFR 223.3(h)(1) and (3).

¹⁰ See 12 CFR 223.22(a).

¹¹ 12 U.S.C. § 371c(f)(2); 12 CFR 223.43(a).

¹² 67 Federal Register 76560 (Dec. 12, 2002).

¹³ See, e.g., Board letters dated July 1, 2008, to Kathryn V. McCulloch, Esq. (JPMorgan Chase & Co.); March 25, 2008, to Karen Grandstrand, Esq. (Minnwest Corporation); December 21, 2007, to Andres L. Navarette, Esq. (Capital One Financial Corporation); and June 30, 2007, to Carl Howard, Esq. (Citigroup Inc.).

equivalent credit quality under the bank's internal rating system. The Assets also must not be low-quality assets (as defined in Regulation W).

- GSGI must, at the request of the Federal Reserve, in the Federal Reserve's full discretion, repurchase any transferred Asset from the bank at the bank's original purchase price.
- For the life of each transferred Asset, GSGI must (i) reimburse the bank for any credit-related loss upon sale by the bank of a transferred Asset and (ii) repurchase any transferred Asset that becomes a low-quality asset (as defined in Regulation W)¹⁴ at the bank's original purchase price.¹⁵ Such reimbursements and repurchases must occur quarterly or more frequently.
- In support of its guarantee, GSGI must pledge to Goldman Bank collateral that is acceptable to the Federal Reserve and in an amount equal to [] percent of the aggregate covered-transaction amount¹⁶ for the life of the transferred Assets. If a decline in value of the collateral causes GSGI to breach the [] percent collateral requirement, additional

¹⁴ GSGI proposes to transfer certain mortgage servicing rights and derivatives to the bank as part of the Assets. Because of certain differences in the nature of these types of assets from the nature of loan assets, the definition of "low-quality asset" in Regulation W (designed primarily to address loans) does not adequately capture when these assets become low quality. See Appendix B for a description of when those assets would be considered "low quality" for purposes of CSGI's guarantee.

¹⁵ Some of the Assets may be transferred with credit default swap ("CDS") protection from GSGI or another affiliate of the bank, or the bank may decide to obtain CDS protection for an Asset from an affiliate after it is transferred. Although the bank may obtain CDS protection from GSGI or another affiliate, the bank may not pay for this protection because the bank would already receive credit protection for the transferred Asset from GSGI under the guarantee described above. GSGI may, however, net payments to the bank under the CDS from any payment obligations to the bank under the guarantee.

¹⁶ The aggregate covered-transaction amount generally is equal to the bank's purchase price for transferred Assets plus the face amount of committed but unfunded credit lines.

collateral must be pledged to return GSGI to compliance with this requirement.¹⁷

- Goldman Bank must maintain a tier 1 leverage capital ratio of at least 6 percent, a tier 1 risk-based capital ratio of at least 8 percent, and a total risk-based capital ratio of at least 11 percent [].
- The Assets must be transferred to the bank by [].

B. Financing Transactions Exemption Request

Goldman Bank also proposes to engage in certain financing transactions (secured by the Assets), such as loan participations, repurchase agreements, and securities-borrowing transactions (collectively, “Financing Transactions”), with affiliates in the transition period before GSGI transfers the Assets to the bank. Consistent with previous requests for exemptions from section 23A that the Board has granted to permit a bank to engage in certain securities financing transactions with its affiliates,¹⁸ Goldman Bank may only engage in Financing Transactions that meet the following conditions:

- The Financing Transactions must be overnight financing transactions that are fully secured, marked-to-market daily, and subject to daily margin-maintenance requirements.
- Collateral for the Financing Transactions must be obligations that are externally rated B- or higher by an NSRO or, for unrated assets, of equivalent credit quality and must not include any “low-quality assets” (as defined in Regulation W).

¹⁷ GSGI may release collateral to the extent that transferred Assets are sold or mature.

¹⁸ See, e.g., Board letters dated October 23, 2007, to Carl Howard, Esq. (Citigroup Inc.); October 12, 2007, to Jay Levine (The Royal Bank of Scotland plc); October 11, 2007, to Alan B. Kaplan, Esq. (Barclays Bank PLC); September 12, 2007, to Michael L. Kadish, Esq. (Deutsche Bank AG); August 20, 2007, to Kathleen A. Juhase, Esq. (JPMorgan Chase & Co.); August 20, 2007, to Patrick S. Antrim, Esq. (Bank of America Corporation); and August 20, 2007, to Carl Howard, Esq. (Citigroup Inc.).

- GSGI must fully guarantee the prompt and full payment of obligations of the affiliate counterparty to each Financing Transaction.
- In support of the guarantee, GSGI must provide collateral equal to [] percent of the amount of the affiliate's obligation for each Financing Transaction.

In previous requests, the Board has permitted a bank to engage in financing transactions only if the transactions would be promptly collectable even in the case of bankruptcy of the affiliate. Because Goldman Bank proposes to engage in certain financing transactions where the bank cannot represent that it would be able to liquidate the transactions promptly in the event of the bankruptcy of the borrowing affiliate, the bank must comply with the following supplemental conditions to address this added risk:

- The aggregate amount of Goldman Bank's Financing Transactions with all its affiliates must not exceed \$[] at any time.
- Goldman Bank may enter into such transactions only until October 29, 2008.

C. Statutory Standards for the Section 23A Exemption Requests

As noted, section 23A and Regulation W specifically authorize the Board to exempt, in its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds the exemption to be in the public interest and consistent with the purposes of section 23A. According to Goldman Bank, these exemptions are in the public interest because the reorganization is expected to enhance the bank's efficiency, thereby allowing it to extend additional credit into the market and serve its customers better. As with previous exemption requests, and consistent with the requirements for certain internal corporate reorganizations in Regulation W,¹⁹ the directors of Goldman Bank have reviewed and approved the transactions described above.

The proposed asset purchase and Financing Transactions by Goldman Bank would be subject to the market-terms requirement of section 23B of the Federal Reserve Act. Section 23B generally requires that transactions between a

¹⁹ 12 CFR 223.41(d).

bank and its affiliates be on terms that are at least as favorable to the bank as the terms of comparable transactions between the bank and a third party.²⁰

In light of these considerations and all the facts and circumstances of this case, the proposed transactions appear to be consistent with safe and sound banking practices and on terms that will ensure the quality of the transferred Assets. Accordingly, the proposed transactions appear to be in the public interest and consistent with the purposes of section 23A. The Board, after consultation with staff of the Federal Deposit Insurance Corporation, hereby grants the requested exemptions.

Anti-Tying Exception Request

Section 106 of the Bank Holding Company Act Amendments of 1970 generally prohibits a bank from conditioning the availability or price of a product on a requirement that the customer obtain another separate product from, or provide another separate product to, the bank or an affiliate of the bank. This statutory prohibition did not apply to products and services provided by the non-bank subsidiaries of Goldman Sachs that were offered or provided without reference to the products or services of Goldman Bank. A small number of loans included in the Assets to be transferred to Goldman Bank might contain conditions that would have violated anti-tying restrictions if the loans had been extended by a bank. As a general matter, it is a violation of section 106 for a bank to acquire such loans from an affiliate. Section 106 authorizes the Board to grant exceptions to the prohibition if the exception is not contrary to the purposes of this section.²¹ In light of all the facts and circumstances of this case, the Board grants an exception from section 106 to permit Goldman Bank to acquire the Assets. Going forward, however, the bank and its subsidiaries will not be permitted to extend or renew any loans on terms that would violate the anti-tying restrictions in section 106.

Conclusion

The Board's determinations are specifically conditioned on compliance by Goldman Bank and GSGI with all the commitments and

²⁰ 12 U.S.C. § 371c-1(a).

²¹ 12 U.S.C. § 1972(1).

representations made in connection with the requests and with the conditions discussed above. These commitments, representations, and conditions are deemed to be conditions imposed in writing in connection with granting the requests and, as such, may be enforced in proceedings under applicable law. The determinations are also based on the specific facts and circumstances surrounding the proposed transactions and may be revoked in the event of any material change in those facts and circumstances or any failure by Goldman Bank or GSGI to observe any of these commitments, representations, or conditions. Granting the requests does not represent a determination concerning the permissibility of any other transactions engaged in by Goldman Bank or GSGI that are subject to section 23A, Regulation W, or section 106.

Sincerely,

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

Attachments

cc: Ivan J. Hurvitz, Vice President
Federal Reserve Bank of New York
Federal Deposit Insurance Corporation

Appendix A

The following subsidiaries are included in the transferred Assets:

- Goldman Sachs Capital Markets, L.P., a multipurpose dealer in over-the-counter fixed-income swaps and other derivatives, primarily interest rate, credit, and foreign exchange derivatives (approximately \$[] in assets).
- Goldman Sachs Credit Partners, a company that buys, sells, and originates secured and unsecured senior commercial loans and provides financing for the purchase of senior bank debt (approximately \$[] in assets).
- Goldman Sachs Mortgage Company, a company that buys, sells, originates, and invests in commercial and residential mortgage loans and related instruments (approximately \$[] in assets).
- William Street Commitment Corporation (“Commitment Corp”) and William Street Credit Corporation (“Credit Corp”), companies that provide unsecured syndicated loan facilities primarily with investment-grade corporate borrowers. Credit Corp holds funded loan assets and Commitment Corp extends commitments. Commitment Corp has approximately \$[] in assets, and Credit Corp has approximately \$[] in assets.
- Goldman Sachs Specialty Lending Holdings, Inc. (“Specialty Lending”) and Goldman Sachs Specialty Lending Holdings, Inc. II (“Specialty Lending II”), companies that originate secured loans to middle-market companies. Specialty Lending has approximately \$[] in assets, and Specialty Lending II has approximately \$[] in assets.

Appendix B

Transferred Assets that are Derivatives

If Goldman Bank downgrades a derivatives counterparty to a [] or below in the bank's internal credit rating system in any calendar quarter during the five years after the proposed transfer, GSGI will promptly, after the end of that quarter, pay Goldman Bank an amount equal to any change in the credit-valuation adjustment of the counterparty (minus the value of any hedge by Goldman Bank that was purchased by GSGI) from the time of consummation of the transfer to the time of the downgrade. Moreover, if a derivatives counterparty defaults at any time during the five years after the proposed transfer, GSGI must promptly pay Goldman Bank an amount equal to the then-replacement cost of the bank's derivative transactions with the counterparty (net of proceeds from any liquidation of collateral or amounts recovered from the defaulting counterparty). In calculating GSGI's payment obligation to the bank upon counterparty default, GSGI may net any previous payment made by GSGI to the bank as a result of an internal rating downgrade of the counterparty.

As an alternative to GSGI's making any such required payment, GSGI may, with the prior consent of the Federal Reserve, repurchase, or otherwise fully compensate Goldman Bank for, the derivative transaction.

Transferred Assets that are Mortgage Servicing Rights

GSGI will make a cash payment to Goldman Bank equal to the amount of any impairment recognized or direct write-downs related to the mortgage servicing rights or servicing advances in that quarter. GSGI must make the cash payment within 30 days after the end of each calendar quarter. Goldman Bank will hold an amount of risk-based capital equal to the impairment recognized or direct write-down taken on any rights or advances so long as Goldman Bank retains ownership or control of the rights or advances. For example, the risk-based capital charge for each impairment recognized or direct write-down related to each right or advance would be 100 percent (equivalent to a 1250 percent risk weight) rather than the 8 percent (equivalent to a 100 percent risk weight) that would apply to a similar asset that is not a part of the rights.

As an alternative to GSGI's making any such required payment, GSGI may, with the consent of the Federal Reserve, repurchase such mortgage servicing rights or advances.