

Goldman Sachs Bank USA and Subsidiaries

Consolidated Financial Statements

As of and for the years ended

December 31, 2011 and December 31, 2010



**Bank
USA**

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Management Report

March 29, 2012

To the Federal Deposit Insurance Corporation, Federal Reserve Bank of New York, New York State Department of Financial Services and the Audit Committee of the Board of Directors of Goldman Sachs Bank USA (the "Bank")

Management's Assessment of Internal Control over Financial Reporting

The management of the Bank is responsible for (i) preparing the Bank's annual financial statements in accordance with generally accepted accounting principles, and (ii) establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Call Report.

The Bank's internal control over financial reporting is a process designed under the supervision of the Bank's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with U.S. generally accepted accounting principles and the instructions for the Call Report, and financial statements for regulatory reporting purposes.

The Bank's internal control over financial reporting includes policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets of the Bank; (ii) provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles and financial statements for regulatory reporting purposes, and that receipts and expenditures of the Bank are being made only in accordance with authorizations of management and directors of the Bank; and (iii) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any evaluation of effectiveness of future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Management assessed the effectiveness of the Bank's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with U.S. generally accepted accounting principles and the instructions

for the Call Report, as of December 31, 2011, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework*.

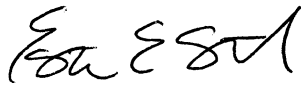
Based upon its assessment, management has concluded that, as of December 31, 2011, the Bank's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with U.S. generally accepted accounting principles and the instructions for the Call Report, is effective based on the criteria established in *Internal Control – Integrated Framework*.

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Call Report, as of December 31, 2011, has been audited by PricewaterhouseCoopers LLP, an independent public accounting firm, as stated in their report dated March 29, 2012.

Management's Assessment of Compliance with Designated Laws and Regulations

The management of the Bank is responsible for complying with Federal laws and regulations pertaining to insider loans and Federal and State laws and regulations pertaining to dividend restrictions.

The management of the Bank has assessed the Bank's compliance with the Federal laws and regulations pertaining to insider loans and the Federal and State laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2011, and has discussed with its supervisory authority a question regarding the coverage of one of those regulations. Based upon such assessment and discussion, management has concluded that the Bank has complied, in all material respects, with the Federal laws and regulations pertaining to insider loans and the Federal and State laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2011.



Chief Executive Officer
Esta Stecher
Goldman Sachs Bank USA



Chief Financial Officer
Kevin Byrne
Goldman Sachs Bank USA



Report of Independent Auditors

To the Board of Directors and Shareholder of Goldman Sachs Bank USA:

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of earnings, shareholder's equity and cash flows present fairly, in all material respects, the financial position of Goldman Sachs Bank USA and its subsidiaries (the Company) at December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included under the heading "Management's Assessment of Internal Control over Financial Reporting" in the accompanying Management Report. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our audits. We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act, our audit of the Company's internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the Federal Financial Institutions Examination Council *Instructions for Consolidated Reports of Condition and Income*. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and



fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and those charged with governance; and (iii) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We have not examined management's assertion regarding its compliance with laws and regulations concerning loans to insiders and federal and state laws and regulations concerning dividend restrictions.

PricewaterhouseCoopers LLP

March 29, 2012

GOLDMAN SACHS BANK USA AND SUBSIDIARIES
Financial Statements

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Consolidated Statements of Earnings

<i>in millions</i>	Year Ended December	
	2011	2010
Revenues		
Interest income	\$ 797	\$ 766
Interest expense	635	1,143
Net interest income/(expense)	162	(377)
Gains and losses from financial instruments, net	3,054	2,798
Other revenues	262	339
Total non-interest revenues	3,316	3,137
Net revenues, including net interest income/(expense)	3,478	2,760
Operating expenses		
Compensation and benefits	174	233
Management charges	603	580
Other expenses	451	297
Total operating expenses	1,228	1,110
Pre-tax earnings	2,250	1,650
Provision for taxes	915	450
Net earnings	\$1,335	\$1,200

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Financial Condition

<i>in millions, except share and per share amounts</i>	As of December	
	2011	2010
Assets		
Cash	\$41,270	\$29,202
Collateralized agreements:		
Securities purchased under agreements to resell, at fair value	5,248	7,927
Loans receivable, net	3,096	2,405
Receivables from customers and counterparties, brokers, dealers and clearing organizations	5,910	3,620
Financial instruments owned, at fair value (includes \$5,345 and \$6,810 pledged as collateral as of December 2011 and December 2010, respectively)	46,574	41,688
Servicing advances receivable, net	–	2,650
Other assets	1,421	1,937
Total assets	\$103,519	\$89,429
Liabilities and shareholder's equity		
Deposits (includes \$2,179 and \$850 at fair value as of December 2011 and December 2010, respectively)	\$44,830	\$32,373
Collateralized financings:		
Securities sold under agreements to repurchase, at fair value	15,275	9,180
Other secured financings (includes \$109 and \$3,158 at fair value as of December 2011 and December 2010, respectively)	209	3,259
Payables to customers and counterparties, brokers, dealers and clearing organizations	4,103	3,387
Financial instruments sold, but not yet purchased, at fair value	17,641	16,147
Subordinated borrowings	–	5,000
Other liabilities and accrued expenses (includes \$269 and \$298 at fair value as of December 2011 and December 2010, respectively)	2,247	1,350
Total liabilities	84,305	70,696
Commitments, contingencies and guarantees		
Shareholder's equity		
Shareholder's equity (includes common stock, par value \$100 per share; 80,000,000 shares authorized, issued and outstanding as of December 2011 and December 2010)	19,214	18,733
Total liabilities and shareholder's equity	\$103,519	\$89,429

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Shareholder's Equity

<i>in millions</i>	Year Ended December	
	2011	2010
Shareholder's equity		
Shareholder's equity, beginning of year	\$18,733	\$17,332
Net earnings	1,335	1,200
Capital contributions from The Goldman Sachs Group, Inc. ¹	146	201
Dividends paid to The Goldman Sachs Group, Inc.	(1,000)	—
Shareholder's equity, end of year	\$19,214	\$18,733

1. Capital contributions for the years ended December 2011 and December 2010 were non-cash. See Note 21 for further information.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

<i>in millions</i>	Year Ended December	
	2011	2010
Cash flows from operating activities		
Net earnings	\$1,335	\$1,200
Non-cash items included in net earnings		
Interest expense	21	194
Depreciation and amortization	176	16
Deferred income taxes	(15)	(109)
Changes in operating assets and liabilities		
Net receivables from customers and counterparties, brokers, dealers and clearing organizations	(1,665)	1,389
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell, at fair value	8,774	4,161
Financial instruments owned, at fair value	(3,016)	2,076
Financial instruments sold, but not yet purchased, at fair value	1,494	(5,786)
Servicing advances receivable, net	180	80
Other, net	884	221
Net cash provided by operating activities	8,168	3,442
Cash flows from investing activities		
Change in loans receivable, net	(691)	(1,007)
Proceeds from sale of Litton Loan Servicing, L.P.	520	–
Net cash used for investing activities	(171)	(1,007)
Cash flows from financing activities		
Deposits, net	12,379	(613)
Repayment of subordinated borrowings	(5,000)	–
Repayment of secured financings	(2,880)	(258)
Dividends paid to The Goldman Sachs Group, Inc.	(1,000)	–
Other, net	572	(1,039)
Net cash provided by/(used for) financing activities	4,071	(1,910)
Net increase in cash	12,068	525
Cash, beginning of year	29,202	28,677
Cash, end of year	\$41,270	\$29,202

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest were \$642 million and \$1.10 billion for the years ended December 2011 and December 2010, respectively.

Cash payments for income taxes, net of refunds, were \$523 million and \$1.14 billion for the years ended December 2011 and December 2010, respectively.

Non-cash activities:

In connection with the sale of Litton Loan Servicing, L.P. (see Note 13) the Bank provided a facility of \$2.13 billion to the buyer. This facility is included in "Financial instruments owned, at fair value."

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1.

Description of Business

Goldman Sachs Bank USA, together with its consolidated subsidiaries (collectively, the Bank), is a wholly-owned subsidiary of The Goldman Sachs Group, Inc. (Group Inc.), a bank holding company and a financial holding company under the U.S. Bank Holding Company Act of 1956. The Bank is a New York State-chartered bank insured by the Federal Deposit Insurance Corporation (FDIC) and is a member of the Federal Reserve System. The Bank is supervised and regulated by the Board of Governors of the Federal Reserve System (Federal Reserve Board), the FDIC and the New York State Department of Financial Services (formerly the New York State Banking Department).

As a prescribed condition of the Bank's reorganization in November 2008, Group Inc. agreed to guarantee certain losses, including credit-related losses, relating to assets contributed by Group Inc. on the date of the reorganization (the Guarantee). Group Inc. also agreed to pledge to the Bank certain collateral, including interests in subsidiaries and other illiquid assets. See Note 21 for further discussion of this Guarantee and other balances with affiliates.

The Bank accepts client and brokered deposits and lends to high-net-worth individuals, institutional and corporate clients and other counterparties. The Bank deals in over-the-counter derivatives, including cash-settled swap agreements, caps, collars, floors, options on swaps and forward settlement contracts in the interest rate, credit and foreign currency markets. The Bank engages in agency lending, custody, and hedge fund administration services.

The Bank facilitates client transactions and makes markets in fixed income products, with clients which include corporations, financial institutions, investment funds, governments and individuals.

The following activities are conducted in the Bank's significant operating subsidiaries:

Goldman Sachs Credit Partners L.P., a Bermuda limited partnership, primarily originates and syndicates commercial purpose senior bank loans to institutional borrowers and also purchases bank loans for its own investment purposes, for securitization and for resale.

Goldman Sachs Mitsui Marine Derivative Products, L.P. (MMDP), a Delaware limited partnership, acts as an intermediary in transactions involving derivative contracts. MMDP is able to provide credit rating enhancement to derivative products due to its partnership with an external

party, Mitsui Sumitomo Insurance Co., Ltd. (Mitsui Sumitomo).

Goldman Sachs Mortgage Company, a New York limited partnership, purchases residential and commercial mortgage loans and other consumer loan assets for its own investment, securitization or resale and provides warehouse and repurchase financing to third parties.

William Street Commitment Corporation (Commitment Corp.) and William Street Credit Corporation, both Delaware corporations, provided unsecured syndicated loan facilities primarily to investment-grade corporate borrowers.

William Street Funding Corporation (Funding Corp.), a Delaware corporation, historically acted as the funding vehicle for a substantial portion of the draws on loan commitments entered into by Commitment Corp. During the year ended December 2011, Funding Corp. was legally dissolved. See Note 18 for further discussion of the William Street credit extension program.

Litton Loan Servicing L.P. (Litton), a Delaware limited partnership, serviced primarily sub-prime residential mortgage loans. Litton was sold on September 1, 2011. See Note 13 for further information regarding the sale of Litton.

All subsidiaries of the Bank are wholly-owned by the Bank, with the exception of MMDP, in which Mitsui Sumitomo has a 50% interest.

Note 2.

Basis of Presentation

These consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and include the accounts of the Bank and all other entities in which the Bank has a controlling financial interest. Intercompany transactions and balances have been eliminated.

All references to 2011 and 2010 refer to December 31, 2011 and December 31, 2010 respectively. Any reference to a future year refers to a year ending on December 31 of that year.

Notes to Consolidated Financial Statements

Note 3.

Significant Accounting Policies

The Bank's significant accounting policies include when and how to measure the fair value of assets and liabilities and when to consolidate an entity. See Notes 5 through 8 for policies on fair value measurements and Note 11 for policies on consolidation accounting. All other significant accounting policies are either discussed below or included in the following footnotes:

Financial Instruments Owned, at Fair Value and Financial Instruments Sold, But Not Yet Purchased, at Fair Value	Note 4
Fair Value Measurements	Note 5
Cash Instruments	Note 6
Derivatives and Hedging Activities	Note 7
Fair Value Option	Note 8
Collateralized Agreements and Financings	Note 9
Securitization Activities	Note 10
Variable Interest Entities	Note 11
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Consolidation

The Bank consolidates entities in which the Bank has a controlling financial interest. The Bank determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity (VIE).

Voting Interest Entities. Voting interest entities are entities in which (i) the total equity investment at risk is sufficient to enable the entity to finance its activities independently, and (ii) the equity holders have the power to direct the activities of the entity that most significantly impact its economic performance, the obligation to absorb the losses of the entity and the right to receive the residual returns of the entity. The usual condition for a controlling financial interest in a voting interest entity is ownership of a majority voting interest. If the Bank has a majority voting interest in a voting interest entity, the entity is consolidated.

Variable Interest Entities. A VIE is an entity that lacks one or more of the characteristics of a voting interest entity. The Bank has a controlling financial interest in a VIE when the Bank has a variable interest or interests that provide it with (i) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. See Note 11 for further information about VIEs.

Use of Estimates

Preparation of these consolidated financial statements requires management to make certain estimates and assumptions, the most important of which relate to fair value measurements and the provision for losses that may arise from litigation, regulatory proceedings and tax audits. These estimates and assumptions are based on the best available information but actual results could be materially different.

Notes to Consolidated Financial Statements**Financial Assets and Financial Liabilities at Fair Value**

Financial instruments owned, at fair value and Financial instruments sold, but not yet purchased, at fair value are recorded at fair value either under the fair value option or in accordance with other U.S. GAAP. In addition, the Bank has elected to account for certain of its other financial assets and financial liabilities at fair value by electing the fair value option. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. Fair value gains or losses are included in "Gains and losses from financial instruments, net." See Notes 5 through 8 for further information about fair value measurements.

Transfers of Assets

Transfers of assets are accounted for as sales when the Bank has relinquished control over the assets transferred. For transfers of assets accounted for as sales, any related gains or losses are recognized in net revenues. Assets or liabilities that arise from the Bank's continuing involvement with transferred assets are measured at fair value. For transfers of assets that are not accounted for as sales, the assets remain in "Financial instruments owned, at fair value" and the transfer is accounted for as a collateralized financing, with the related interest expense recognized over the life of the transaction. See Note 9 for further information about transfers of assets accounted for as collateralized financings and Note 10 for further information about transfers of assets accounted for as sales.

Receivables from Customers and Counterparties, Brokers, Dealers and Clearing Organizations

Receivables from customers and counterparties generally consist of collateralized receivables related to client transactions including collateral posted in connection with certain derivative transactions. Receivables from customers and counterparties are accounted for at amortized cost net of estimated uncollectible amounts, which generally approximates fair value. Interest on receivables from customers and counterparties is recognized over the life of the transaction and included in "Interest income."

Foreign Currency Translation

Assets and liabilities denominated in non-U.S. currencies are translated at rates of exchange prevailing on the date of the consolidated statements of financial condition and revenues and expenses are translated at average rates of exchange for the period. Foreign currency remeasurement gains or losses are recognized in earnings.

Cash

Cash includes funds held at the Federal Reserve Bank (\$40.06 billion and \$28.12 billion as of December 2011 and 2010, respectively) and cash deposits held at other financial institutions.

Within the cash balance held at the Federal Reserve Bank, \$551 million and \$670 million are maintained to meet regulatory reserve requirements, as of December 2011 and December 2010, respectively.

As of December 2011 and December 2010, cash included \$40.83 billion and \$28.99 billion, respectively, of interest-bearing deposits with banks.

Notes to Consolidated Financial Statements**Recent Accounting Developments**

Improving Disclosures about Fair Value Measurements (FASB Accounting Standards Codification (ASC) 820). In January 2010, the FASB issued ASU No. 2010-06, “Fair Value Measurements and Disclosures (Topic 820) — Improving Disclosures about Fair Value Measurements.” ASU No. 2010-06 provides amended disclosure requirements related to fair value measurements. Certain of these disclosure requirements became effective for the Bank beginning in 2010, while others became effective for the Bank beginning in 2011. Since these amended principles require only additional disclosures concerning fair value measurements, adoption did not affect the Bank’s financial condition, results of operations or cash flows.

Reconsideration of Effective Control for Repurchase Agreements (ASC 860). In April 2011, the FASB issued ASU No. 2011-03, “Transfers and Servicing (Topic 860) — Reconsideration of Effective Control for Repurchase Agreements.” ASU No. 2011-03 changes the assessment of effective control by removing (i) the criterion that requires the transferor to have the ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee, and (ii) the collateral maintenance implementation guidance related to that criterion. ASU No. 2011-03 is effective for periods beginning after December 15, 2011. Adoption of ASU No. 2011-03 will not affect the Bank’s financial condition, results of operations or cash flows.

Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASC 820). In May 2011, the FASB issued ASU No. 2011-04, “Fair Value Measurements and Disclosures (Topic 820) — Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.” ASU No. 2011-04 clarifies the application of existing fair value measurement and disclosure requirements, changes certain principles related to measuring fair value, and requires additional disclosures about fair value measurements. ASU No. 2011-04 is effective for periods beginning after December 15, 2011. Adoption of ASU No. 2011-04 will not materially affect the Bank’s financial condition, results of operations or cash flows.

Disclosures about Offsetting Assets and Liabilities (ASC 210). In December 2011, the FASB issued ASU No. 2011-11, “Balance Sheet (Topic 210) — Disclosures about Offsetting Assets and Liabilities.” ASU No. 2011-11 will require disclosure of the effect or potential effect of offsetting arrangements on the Bank’s financial position as well as enhanced disclosure of the rights of setoff associated with the Bank’s recognized assets and recognized liabilities. ASU No. 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. Since these amended principles require only additional disclosures concerning offsetting and related arrangements, adoption will not affect the Bank’s financial condition, results of operations or cash flows.

Notes to Consolidated Financial Statements

Note 4.

Financial Instruments Owned, at Fair Value and Financial Instruments Sold, But Not Yet Purchased, at Fair Value

Financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value are accounted for at fair value either under the fair value option or in accordance with other U.S. GAAP. See Note 8 for further information about the fair value option. The table

below presents the Bank's financial instruments owned, at fair value, including those pledged as collateral, and financial instruments sold, but not yet purchased, at fair value.

<i>in millions</i>	As of December 2011		As of December 2010	
	Financial Instruments Owned	Financial Instruments Sold, But Not Yet Purchased	Financial Instruments Owned	Financial Instruments Sold, But Not Yet Purchased
Money market instruments	\$ –	\$ –	\$ 4,060 ⁵	\$ –
U.S. government and federal agency obligations	1,388	2,677	3,081	2,958
Non-U.S. government obligations	3,854	2,837	3,330	2,711
Mortgage and other asset-backed loans and securities:				
Loans and securities backed by commercial real estate ¹	1,067	–	629	1
Loans backed by residential real estate	1,436	–	1,139	–
Bank loans and bridge loans	7,137	1,846 ⁴	3,268	812 ⁴
Corporate debt securities	153	50	199	51
Other ²	251	–	122	–
Derivatives ³	31,288	10,231	25,860	9,614
Total	\$46,574	\$17,641	\$41,688	\$16,147

1. Includes \$1.04 billion in commercial loans and \$23 million in commercial mortgage-backed securities.
2. Primarily consists of other debt obligations and equity investments.
3. Net of cash collateral received or posted under credit support agreements and reported on a net-by-counterparty basis when a legal right of setoff exists under an enforceable netting agreement.
4. Primarily consists of the fair value of unfunded commitments to extend credit. The fair value of partially funded commitments is primarily included in "Financial instruments owned, at fair value."
5. Money market instruments held by Funding Corp. to support the William Street credit extension program. See Note 18 for further information about the William Street credit extension program.

Notes to Consolidated Financial Statements

Gains and Losses from Financial Instruments, net

The table below presents, by major product type, gains/(losses) related to the Bank's financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value including both derivative and nonderivative financial instruments. These gains/(losses) are included in "Gains and losses from financial instruments, net" and exclude related interest income and interest expense. See Note 22 for further information about interest income and interest expense.

The gains/(losses) in the table are not representative of the manner in which the Bank manages its businesses because many of the Bank's market-making and other activities utilize financial instruments across various product types. Accordingly, gains or losses in one product type frequently offset gains or losses in other product types. For example, most of the Bank's longer-term derivatives are sensitive to changes in interest rates and may be economically hedged with interest rate swaps. Similarly, a significant portion of the Bank's cash instruments and derivatives has exposure to foreign currencies and may be economically hedged with foreign currency contracts.

<i>in millions</i>	Year Ended December	
	2011	2010
Interest rates	\$ 2,641	\$ 204
Currencies	(1,647)	950
Credit	2,060	1,644
Total	\$ 3,054	\$2,798

Note 5.

Fair Value Measurements

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs.

The best evidence of fair value is a quoted price in an active market. If listed prices or quotations are not available, fair value is determined by reference to prices for similar instruments, quoted prices or recent transactions in less active markets, or internally developed models that primarily use as inputs market-based or independently sourced parameters, including, but not limited to, interest rates, volatilities, debt prices, foreign exchange rates, credit curves and funding rates.

U.S. GAAP has a three-level fair value hierarchy for disclosure of fair value measurements. The fair value hierarchy prioritizes inputs to the valuation techniques used to measure fair value, giving the highest priority to level 1 inputs and the lowest priority to level 3 inputs. A financial instrument's level in the fair value hierarchy is based on the lowest level of input that is significant to its fair value measurement.

The fair value hierarchy is as follows:

Level 1. Inputs are unadjusted quoted prices in active markets to which the Bank had access at the measurement date for identical, unrestricted assets or liabilities.

Level 2. Inputs to valuation techniques are observable, either directly or indirectly.

Level 3. One or more inputs to valuation techniques are significant and unobservable.

Notes to Consolidated Financial Statements

The fair values for substantially all of our financial assets and financial liabilities are based on observable prices and inputs and are classified in levels 1 and 2 of the hierarchy. Certain level 2 and level 3 financial assets and financial liabilities may require appropriate valuation adjustments that a market participant would require to arrive at fair value for factors such as counterparty and the Bank's credit quality, funding risk, transfer restrictions, liquidity and bid/offer spreads. Valuation adjustments are generally based on market evidence. See Notes 6, 7 and 8 for further information about valuation adjustments.

See Notes 6 and 7 for further information about fair value measurements of cash instruments and derivatives, respectively, included in "Financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value," and Note 8 for further information about other financial assets and financial liabilities accounted for at fair value under the fair value option.

Financial assets and financial liabilities at fair value are summarized below.

<i>\$ in millions</i>	As of December	
	2011	2010
Total level 1 financial assets	\$ 5,230	\$ 10,300
Total level 2 financial assets	103,353	93,244
Total level 3 financial assets	7,042	6,834
Netting and collateral ¹	(63,803)	(60,763)
Total financial assets at fair value	\$ 51,822	\$ 49,615
Total assets	\$103,519	\$ 89,429
Total level 3 financial assets as a percentage of Total assets	6.8%	7.6%
Total level 3 financial assets as a percentage of Total financial assets at fair value	13.6%	13.8%
Total level 3 financial liabilities at fair value	\$ 3,179	\$ 4,844
Total financial liabilities at fair value	\$ 35,473	\$ 29,633
Total level 3 financial liabilities as a percentage of Total financial liabilities at fair value	9.0%	16.3%

1. Represents the impact on derivatives of cash collateral and counterparty netting across levels of the fair value hierarchy. Netting among positions classified in the same level is included in that level.

See Notes 6, 7, and 8 for further information about level 3 cash instruments, derivatives and other financial assets and financial liabilities accounted for at fair value under the fair

value option, respectively, including information about significant unrealized gains/(losses) and significant transfers in or out of level 3.

Notes to Consolidated Financial Statements**Note 6.****Cash Instruments**

Cash instruments include U.S. government and federal agency obligations, non-U.S. government obligations, bank loans and bridge loans, corporate debt securities and other non-derivative financial instruments owned and financial instruments sold, but not yet purchased. See below for the types of cash instruments included in each level of the fair value hierarchy and the valuation techniques and significant inputs used to determine their fair values. See Note 5 for an overview of the Bank's fair value measurement policies.

Level 1 Cash Instruments

Level 1 cash instruments include U.S. government obligations and most non-U.S. government obligations. These instruments are valued using quoted prices for identical unrestricted instruments in active markets. The Bank defines active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity.

The fair value of a level 1 instrument is calculated as quantity held multiplied by quoted market price. U.S. GAAP prohibits valuation adjustments being applied to level 1 instruments even in situations where the Bank holds a large position and a sale could impact the quoted price.

Level 2 Cash Instruments

Level 2 cash instruments include certain non-U.S. government obligations, corporate debt securities, certain mortgage-backed loans, and certain bank loans and bridge loans and lending commitments.

Valuations of level 2 cash instruments can be verified to quoted prices, recent trading activity for identical or similar instruments, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g., indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources.

Valuation adjustments are typically made to level 2 cash instruments (i) if the cash instrument is subject to transfer restrictions and/or (ii) for other premiums and liquidity discounts that a market participant would require to arrive at fair value. Valuation adjustments are generally based on market evidence.

Level 3 Cash Instruments

Level 3 cash instruments have one or more significant valuation inputs that are not observable. Absent evidence to the contrary, level 3 cash instruments are initially valued at transaction price, which is considered to be the best initial estimate of fair value. Subsequently, the Bank uses other methodologies to determine fair value, which vary based on the type of instrument. Valuation inputs and assumptions are changed when corroborated by substantive observable evidence, including values realized on sales of level 3 financial assets.

The table below presents the valuation techniques and the nature of significant inputs generally used to determine the fair values of each class of level 3 cash instrument.

Notes to Consolidated Financial Statements

Level 3 Cash Instrument	Valuation Techniques and Significant Inputs
<p>Loans and securities backed by commercial real estate</p> <ul style="list-style-type: none"> • Collateralized by a single commercial real estate property or a portfolio of properties • May include tranches of varying levels of subordination 	<p>Valuation techniques vary by instrument, but are generally based on discounted cash flow techniques. Significant inputs for these valuations include:</p> <ul style="list-style-type: none"> • Transaction prices in both the underlying collateral and instruments with the same or similar underlying collateral • Current levels and changes in market indices such as the CMBX (an index that tracks the performance of commercial mortgage bonds) • Market yields implied by transactions of similar or related assets • Current performance of the underlying collateral • Capitalization rates and multiples • Amount and timing of future cash flows
<p>Loans backed by residential real estate</p> <ul style="list-style-type: none"> • Collateralized by portfolios of residential real estate • May include tranches of varying levels of subordination 	<p>Valuation techniques vary by instrument, but are generally based on relative value analyses, discounted cash flow techniques or a combination thereof. Significant inputs are determined based on relative value analyses, which incorporate comparisons to instruments with similar collateral and risk profiles, including relevant indices such as the ABX (an index that tracks the performance of subprime residential mortgage bonds). Significant inputs include:</p> <ul style="list-style-type: none"> • Home price projections, residential property liquidation timelines and related costs • Loan prepayment, default and cumulative loss expectations • Transaction prices in both the underlying collateral and instruments with the same or similar underlying collateral • Market yields implied by transactions of similar or related assets
<p>Bank loans and bridge loans Corporate debt securities</p>	<p>Valuation techniques vary by instrument, but are generally based on discounted cash flow techniques. Significant inputs are generally determined based on relative value analyses, which incorporate comparisons both to prices of credit default swaps that reference the same or similar underlying credit risk and to other debt instruments for the same issuer for which observable prices or broker quotations are available. Significant inputs include:</p> <ul style="list-style-type: none"> • Amount and timing of expected future cash flows • Current levels and trends of market indices such as CDX, LCDX and MCDX (indices that track the performance of corporate credit, loans and municipal obligations, respectively) • Market yields implied by transactions of similar or related assets • Current performance and recovery assumptions and, where the Bank uses credit default swaps to value the related cash instrument, the cost of borrowing the underlying reference obligation

Notes to Consolidated Financial Statements

Fair Value of Cash Instruments by Level

The tables below present, by level within the fair value hierarchy, cash instrument assets and liabilities, at fair value. Cash instrument assets and liabilities are included in

“Financial instruments owned, at fair value” and “Financial instruments sold, but not yet purchased, at fair value,” respectively.

<i>in millions</i>	Cash Instrument Assets at Fair Value as of December 2011			
	Level 1	Level 2	Level 3	Total
U.S. government and federal agency obligations	\$ 1,388	\$ –	\$ –	\$1,388
Non-U.S. government obligations	3,842	12	–	3,854
Mortgage and other asset-backed loans and securities:				
Loans and securities backed by commercial real estate ¹	–	942	125	1,067
Loans backed by residential real estate	–	1,326	110	1,436
Bank loans and bridge loans	–	3,991	3,146	7,137
Corporate debt securities	–	153	–	153
Other ²	–	15	236	251
Total	\$5,230	\$6,439	\$3,617	\$15,286

<i>in millions</i>	Cash Instrument Liabilities at Fair Value as of December 2011			
	Level 1	Level 2	Level 3	Total
U.S. government and federal agency obligations	\$2,677	\$ –	\$ –	\$2,677
Non-U.S. government obligations	2,837	–	–	2,837
Bank loans and bridge loans	–	1,319	527	1,846
Corporate debt securities	–	50	–	50
Total	\$5,514	\$1,369	\$527	\$7,410

1. Includes \$1.04 billion in commercial loans and \$23 million in commercial mortgage-backed securities.
2. Primarily consists of other debt obligations and equity investments.

Notes to Consolidated Financial Statements

<i>in millions</i>	Cash Instrument Assets at Fair Value as of December 2010			
	Level 1	Level 2	Level 3	Total
Money market instruments	\$ 4,060	\$ –	\$ –	\$ 4,060
U.S. government and federal agency obligations	2,935	146	–	3,081
Non-U.S. government obligations	3,300	30	–	3,330
Mortgage and other asset-backed loans:				
Loans backed by commercial real estate	–	589	40	629
Loans backed by residential real estate	–	13	1,126	1,139
Bank loans and bridge loans	–	1,563	1,705	3,268
Corporate debt securities	–	198	1	199
Other ¹	5	35	82	122
Total	\$10,300	\$2,574	\$2,954	\$15,828

<i>in millions</i>	Cash Instrument Liabilities at Fair Value as of December 2010			
	Level 1	Level 2	Level 3	Total
U.S. government and federal agency obligations	\$2,956	\$ 2	\$ –	\$2,958
Non-U.S. government obligations	2,641	70	–	2,711
Mortgage and other asset-backed loans:				
Loans backed by commercial real estate	–	1	–	1
Bank loans and bridge loans	–	586	226	812
Corporate debt securities	–	39	12	51
Total	\$5,597	\$698	\$238	\$6,533

1. Primarily consists of equity investments.

Notes to Consolidated Financial Statements

Level 3 Rollforward

If a cash instrument asset or liability was transferred to level 3 during a reporting period, its entire gain or loss for the period is included in level 3. Transfers between levels are reported at the beginning of the reporting period in which they occur.

Level 3 cash instruments are frequently economically hedged with level 1 and level 2 cash instruments and/or level 1, level 2 or level 3 derivatives. Accordingly, gains or losses that are reported in level 3 can be partially offset by

gains or losses attributable to level 1 or level 2 cash instruments and/or level 1, level 2 or level 3 derivatives. As a result, gains or losses included in the level 3 rollforward below do not necessarily represent the overall impact on the Bank's results of operations, liquidity or capital resources.

The tables below present changes in fair value for all cash instrument assets and liabilities categorized as level 3 as of the end of the year.

Level 3 Cash Instrument Assets at Fair Value for the Year Ended December 2011

<i>in millions</i>	Balance, beginning of year	Net realized gains/(losses)	Net unrealized gains/(losses) relating to instruments still held at year-end	Purchases ³	Sales	Settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Mortgage and other asset-backed loans and securities:								
Loans and securities backed by commercial real estate ¹	\$ 40	\$ 3	\$ –	\$ 107	\$ (17)	\$ (3)	\$ (5)	\$ 125
Loans backed by residential real estate	1,126	11	5	42	(193)	(37)	(844) ⁴	110
Bank loans and bridge loans	1,705	79	(23)	2,519	(727)	(346)	(61)	3,146
Corporate debt securities	1	–	–	–	(1)	–	–	–
Other ²	82	19	(44)	302	(20)	(50)	(53)	236
Total	\$2,954	\$ 112	\$(62)	\$2,970	\$(958)	\$(436)	\$(963)	\$3,617

Level 3 Cash Instrument Liabilities at Fair Value for the Year Ended December 2011

<i>in millions</i>	Balance, beginning of year	Net realized (gains)/losses	Net unrealized (gains)/losses relating to instruments still held at year-end	Purchases	Sales	Settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Total	\$ 238	\$(14)	\$129	\$(340)	\$ 306	\$ 226	\$ (18)	\$ 527

1. Includes \$102 million in commercial loans and \$23 million in commercial mortgage-backed securities.
2. Primarily consists of other debt obligations and equity investments.
3. Includes both originations and secondary market purchases.
4. Principally due to transfers to level 2 of certain loans due to improved transparency of market prices used to value these loans, as well as unobservable inputs no longer significant to the valuation of these loans.

The net unrealized loss on level 3 cash instrument assets and liabilities of \$191 million for the year ended December 2011 primarily consisted of losses on unfunded

bank loans and bridge loans, primarily reflecting the impact of unfavorable credit markets.

Notes to Consolidated Financial Statements

Level 3 Cash Instrument Assets at Fair Value for the Year Ended December 2010

<i>in millions</i>	Balance, beginning of year	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at year-end	Net purchases, sales and settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Mortgage and other asset-backed loans:						
Loans backed by commercial real estate	\$ 131	\$ 9	\$ –	\$(99)	\$(1)	\$40
Loans backed by residential real estate	943	46	24	113	–	1,126
Bank loans and bridge loans	1,133	70	66	203	233 ²	1,705
Corporate debt securities	5	1	–	(3)	(2)	1
Other ¹	3	(5)	12	73	(1)	82
Total	\$2,215	\$ 121	\$102	\$287	\$229	\$2,954

Level 3 Cash Instrument Liabilities at Fair Value for the Year Ended December 2010

<i>in millions</i>	Balance, beginning of year	Net realized (gains)/ losses	Net unrealized (gains)/losses relating to instruments still held at year-end	Net purchases, sales and settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Total	\$ 260	\$ (16)	\$ 8	\$ 6	\$ (20)	\$ 238

1. Primarily consists of equity investments.
2. Transfers of bank loans into level 3 were due to certain unobservable inputs.

The net unrealized gain on level 3 cash instrument assets and liabilities of \$94 million for the year ended December 2010 primarily consisted of unrealized gains on certain bank

loans and loans backed by residential real estate, where prices were generally corroborated through market transactions in similar financial instruments during the year.

Notes to Consolidated Financial Statements

Note 7.

Derivatives and Hedging Activities

Derivative Activities

Derivatives are instruments that derive their value from underlying asset prices, indices, reference rates and other inputs, or a combination of these factors. Derivatives may be privately negotiated contracts, which are usually referred to as over-the-counter (OTC) derivatives, or they may be listed and traded on an exchange (exchange-traded). However, the Bank does not generally deal in exchange-traded derivatives.

Market-Making. The Bank enters into derivative transactions with clients and other market participants to provide liquidity and to facilitate the transfer and hedging of risk. Clients enter into derivatives to mitigate or modify interest rate, credit, foreign exchange, and other risks. In order to manage the risk from derivative transactions with clients, the Bank may enter into offsetting positions in other derivatives or purchase or sell cash instruments.

Risk Management. The Bank also enters into derivatives to actively manage risk exposures that arise from market-making and investing and lending activities in derivative and cash instruments. The Bank's holdings and exposures are hedged, in many cases, on either a portfolio or risk-specific basis, as opposed to an instrument-by-instrument basis. The offsetting impact of this economic hedging is reflected in the same business segment as the related revenues. In addition, the Bank may enter into derivatives designated as hedges under U.S. GAAP to manage interest rate exposure in certain fixed-rate certificates of deposit.

The Bank enters into various types of derivatives, including:

- **Futures and Forwards.** Contracts that commit counterparties to purchase or sell financial instruments or currencies in the future.
- **Swaps.** Contracts that require counterparties to exchange cash flows such as currency or interest payment streams. The amounts exchanged are based on the specific terms of the contract with reference to specified rates, financial instruments, currencies or indices.
- **Options.** Contracts in which the option purchaser has the right, but not the obligation, to purchase from or sell to the option writer financial instruments or currencies within a defined time period for a specified price.

Derivatives are accounted for at fair value, net of cash collateral received or posted under credit support agreements. Derivatives are reported on a net-by-counterparty basis (i.e., the net payable or receivable for derivative assets and liabilities for a given counterparty) when a legal right of setoff exists under an enforceable netting agreement. Derivative assets and liabilities are included in "Financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value," respectively.

Gains and losses on derivatives not designated as hedges under U.S. GAAP are included in "Gains and losses from financial instruments, net."

Notes to Consolidated Financial Statements

The table below presents the fair value and the number of derivative contracts by major product type on a gross basis. Gross fair values in the table below exclude the effects of both netting under enforceable netting agreements and netting of cash collateral received or posted under credit support agreements, and therefore are not representative of the Bank's exposure.

<i>in millions, except number of contracts</i>	As of December 2011			As of December 2010		
	Derivative Assets	Derivative Liabilities	Number of Contracts	Derivative Assets	Derivative Liabilities	Number of Contracts
Derivatives not accounted for as hedges						
Interest rates	\$800,448	\$766,454	320,795	\$569,188	\$537,207	298,979
Credit	14,135	13,827	20,079	13,373	12,833	23,811
Currencies	69,003	54,308	28,093	63,825	49,795	23,234
Commodities	144	144	204	191	252	178
Equities	3	9	41	20	30	45
Subtotal	883,733	834,742	369,212	646,597	600,117	346,247
Derivatives accounted for as hedges						
Interest rates	537	3	452	539	—	402
Gross fair value of derivatives	\$884,270	\$834,745	369,664	\$647,136	\$600,117	346,649
Counterparty netting ¹	(790,302)	(790,302)		(561,833)	(561,833)	
Cash collateral netting ²	(62,680)	(34,212)		(59,443)	(28,670)	
Fair value included in financial instruments owned	\$ 31,288			\$ 25,860		
Fair value included in financial instruments sold, but not yet purchased		\$ 10,231			\$ 9,614	

1. Represents the netting of receivable balances with payable balances for the same counterparty under enforceable netting agreements.
2. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.

Notes to Consolidated Financial Statements

Valuation Techniques for Derivatives

See Note 5 for an overview of the Bank's fair value measurement policies.

Level 1 Derivatives

Exchange-traded derivatives fall within level 1 if they are actively traded and are valued at their quoted market price.

Level 2 Derivatives

Level 2 derivatives include OTC derivatives for which all significant valuation inputs are corroborated by market evidence.

Inputs to the valuations of level 2 OTC derivatives can be verified to market-clearing transactions, broker or dealer quotations or other alternative pricing sources with reasonable levels of price transparency. Consideration is given to the nature of the quotations (e.g., indicative or firm) and the relationship of recent market activity to the prices provided from alternative pricing sources.

Where models are used, the selection of a particular model to value an OTC derivative depends on the contractual terms of and specific risks inherent in the instrument, as well as the availability of pricing information in the market. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates, loss severity rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, model selection does not involve significant management judgment because outputs of models can be calibrated to market-clearing levels.

Price transparency of OTC derivatives can generally be characterized by product type.

Interest Rate. In general the prices and other inputs used to value interest rate derivatives are transparent, even for long-dated contracts. Interest rate swaps and options denominated in the currencies of leading industrialized nations are characterized by high trading volumes and tight bid/offer spreads. Interest rate derivatives that reference indices, such as an inflation index, or the shape of the yield curve (e.g., 10-year swap rate vs. 2-year swap rate), are more complex and are therefore less transparent, but the prices and other inputs are generally observable.

Credit. Price transparency for credit default swaps, including both single names and baskets of credits, varies by market and underlying reference entity or obligation. Credit default swaps that reference indices, large corporates and major sovereigns generally exhibit the most price transparency. For credit default swaps with other underliers, price transparency varies based on credit rating, the cost of borrowing the underlying reference obligations, and the availability of the underlying reference obligations for delivery upon the default of the issuer. Credit default swaps that reference loans, asset-backed securities and emerging market debt instruments tend to be less transparent than those that reference corporate bonds. In addition, more complex credit derivatives, such as those sensitive to the correlation between two or more underlying reference obligations, generally have less price transparency.

Currency. Prices for currency derivatives based on the exchange rates of leading industrialized nations including those with longer tenors, are generally transparent. The primary difference between the transparency of developed and emerging market currency derivatives is that emerging markets tend to be observable for contracts with shorter tenors.

Liquidity is essential to observability of all product types. If transaction volumes decline, previously transparent prices and other inputs may become unobservable. Conversely, even highly structured products may at times have trading volumes large enough to provide observability of prices and other inputs.

Notes to Consolidated Financial Statements**Level 3 Derivatives**

Level 3 OTC derivatives are valued using models which utilize observable level 1 and/or level 2 inputs as well as unobservable level 3 inputs.

- For the majority of the Bank's interest rate and currency derivatives classified within level 3, the significant unobservable inputs are correlations of certain currencies and interest rates (e.g., the correlation of Euro foreign exchange rates to U.S. dollar interest rates).
- For credit derivatives classified within level 3, significant level 3 inputs include long-dated credit and funding spreads as well as certain correlation inputs required to value certain credit derivatives (e.g., the likelihood of default of the underlying reference obligations relative to one another).

Subsequent to the initial valuation of a level 3 OTC derivative, the Bank updates the level 1 and level 2 inputs to reflect observable market changes and any resulting gains and losses are recorded in level 3. Level 3 inputs are changed when corroborated by evidence such as similar market transactions, third-party pricing services and/or broker or dealer quotations or other empirical market data. In circumstances where the Bank cannot verify the model value by reference to market transactions, it is possible that a different valuation model could produce a materially different estimate of fair value.

Valuation Adjustments

Valuation adjustments are integral to determining the fair value of derivatives and are used to adjust the mid-market valuations, produced by derivative pricing models, to the appropriate exit price valuation. These adjustments incorporate bid/offer spreads, the cost of liquidity on illiquid positions, credit valuation adjustments (CVA) and funding valuation adjustments, which account for the credit and funding risk inherent in derivative portfolios. Market-based inputs are generally used when calibrating valuation adjustments to market-clearing levels.

In addition, for derivatives that include significant unobservable inputs, the Bank makes model or exit price adjustments to account for the valuation uncertainty present in the transaction.

Notes to Consolidated Financial Statements

Fair Value of Derivatives by Level

The tables below present the fair value of derivatives on a gross basis by level and major product type. Gross fair values in the tables below exclude the effects of both netting under enforceable netting agreements and netting of cash

received or posted under credit support agreements both in and across levels of the fair value hierarchy, and therefore are not representative of the Bank's exposure.

Derivative Assets at Fair Value as of December 2011

<i>in millions</i>	Derivative Assets at Fair Value as of December 2011				Total
	Level 1	Level 2	Level 3	Cross-Level Netting	
Interest rates	\$ –	\$800,616	\$ 369	\$ –	\$800,985
Credit	–	12,019	2,116	–	14,135
Currencies	–	67,092	1,911	–	69,003
Commodities	–	144	–	–	144
Equities	–	3	–	–	3
Gross fair value of derivative assets	\$ –	\$879,874	\$4,396	–	\$884,270
Counterparty netting ¹	–	(787,651)	(1,528)	\$(1,123) ³	(790,302)
Subtotal	\$ –	\$ 92,223	\$2,868	\$(1,123)	\$93,968
Cash collateral netting ²					(62,680)
Fair value included in financial instruments owned					\$ 31,288

Derivative Liabilities at Fair Value as of December 2011

<i>in millions</i>	Derivative Liabilities at Fair Value as of December 2011				Total
	Level 1	Level 2	Level 3	Cross-Level Netting	
Interest rates	\$ –	\$765,787	\$ 670	\$ –	\$766,457
Credit	–	11,822	2,005	–	13,827
Currencies	–	52,976	1,332	–	54,308
Commodities	–	144	–	–	144
Equities	–	9	–	–	9
Gross fair value of derivative liabilities	\$ –	\$830,738	\$4,007	–	\$834,745
Counterparty netting ¹	–	(787,651)	(1,528)	\$(1,123) ³	(790,302)
Subtotal	\$ –	\$43,087	\$2,479	\$(1,123)	\$44,443
Cash collateral netting ²					(34,212)
Fair value included in financial instruments sold, but not yet purchased					\$ 10,231

1. Represents the netting of receivable balances with payable balances for the same counterparty under enforceable netting agreements.
2. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.
3. Represents the netting of receivable balances with payable balances for the same counterparty across levels of the fair value hierarchy under enforceable netting agreements.

Notes to Consolidated Financial Statements

Derivative Assets at Fair Value as of December 2010

<i>in millions</i>	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	\$	\$ 569,340	\$ 387	\$ –	\$ 569,727
Credit	–	10,246	3,127	–	13,373
Currencies	–	62,149	1,676	–	63,825
Commodities	–	191	–	–	191
Equities	–	17	3	–	20
Gross fair value of derivative assets	\$	\$ 641,943	\$ 5,193	–	\$ 647,136
Counterparty netting ¹	–	(559,100)	(1,413)	\$(1,320) ³	(561,833)
Subtotal	\$	\$ 82,843	\$ 3,780	\$(1,320)	\$ 85,303
Cash collateral netting ²					(59,443)
Fair value included in financial instruments owned					\$ 25,860

Derivative Liabilities at Fair Value as of December 2010

<i>in millions</i>	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	\$	\$ 536,842	\$ 365	\$ –	\$ 537,207
Credit	–	11,168	1,665	–	12,833
Currencies	–	48,893	902	–	49,795
Commodities	–	252	–	–	252
Equities	–	27	3	–	30
Gross fair value of derivative liabilities	\$	\$ 597,182	\$ 2,935	–	\$ 600,117
Counterparty netting ¹	–	(559,100)	(1,413)	\$(1,320) ³	(561,833)
Subtotal	\$	\$ 38,082	\$ 1,522	\$(1,320)	\$ 38,284
Cash collateral netting ²					(28,670)
Fair value included in financial instruments sold, but not yet purchased					\$ 9,614

1. Represents the netting of receivable balances with payable balances for the same counterparty under enforceable netting agreements.
2. Represents the netting of cash collateral received and posted on a counterparty basis under credit support agreements.
3. Represents the netting of receivable balances with payable balances for the same counterparty across levels of the fair value hierarchy under enforceable netting agreements.

Notes to Consolidated Financial Statements

Level 3 Rollforward

If a derivative was transferred to level 3 during a reporting period, its entire gain or loss for the period is included in level 3. Transfers between levels are reported at the beginning of the reporting period in which they occur.

Gains and losses on level 3 derivatives should be considered in the context of the following:

- A derivative with level 1 and/or level 2 inputs is classified in level 3 in its entirety if it has at least one significant level 3 input.
- If there is one significant level 3 input, the entire gain or loss from adjusting only observable inputs (i.e., level 1 and level 2 inputs) is classified as level 3.

- Gains or losses that have been reported in level 3 resulting from changes in level 1 or level 2 inputs are frequently offset by gains or losses attributable to level 1 or level 2 derivatives and/or level 1, level 2, and level 3 cash instruments. As a result, gains/(losses) included in the level 3 rollforward below do not necessarily represent the overall impact on the Bank's results of operations, liquidity or capital resources.

The tables below present changes in fair value for all derivatives categorized as level 3 as of the end of the year.

Level 3 Derivative Assets and Liabilities at Fair Value for the Year Ended December 2011

<i>in millions</i>	Asset/ (liability) balance, beginning of year	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at year-end	Purchases	Sales	Settlements	Net transfers in and/or (out) of level 3	Asset/ (liability) balance, end of year
Interest rates – net	\$ 22	\$(59)	\$ (173)	\$ 27	\$ (24)	\$ 50	\$(144)	\$ (301)
Credit – net	1,462	(57)	97	5	(14)	(843)	(539) ¹	111
Currencies – net	774	11	(383)	27	(1)	(83)	234	579
Total derivatives – net	\$2,258	\$(105)	\$(459)	\$59	\$(39)	\$(876)	\$(449)	\$389

1. Net transfer out of level 3 primarily reflecting transfers to level 2 of certain credit derivative assets principally due to unobservable inputs no longer being significant to the valuation of these derivatives.

The net unrealized loss on level 3 derivatives of \$459 million for the year ended December 2011 was primarily attributable to the impact of changes in interest rates and

foreign exchange rates underlying certain currency and interest rate derivatives.

Level 3 Derivative Assets and Liabilities at Fair Value for the Year Ended December 2010

<i>in millions</i>	Asset/ (liability) balance, beginning of year	Net realized gains/ (losses)	Net unrealized gains/(losses) relating to instruments still held at year-end	Net purchases, sales and settlements	Net transfers in and/or (out) of level 3	Asset/ (liability) balance, end of year
Interest rates – net	\$ (80)	\$ (67)	\$ 13	\$ 71	\$ 85	\$ 22
Credit – net	2,135	(104)	127	25	(721)	1,462
Currencies – net	(8)	(80)	152	80	630 ¹	774
Total derivatives – net	\$2,047	\$(251)	\$292	\$176	\$ (6)	\$2,258

1. Net transfer into level 3 principally due to reduced transparency of the correlation inputs used to value these financial instruments.

The net unrealized gain on level 3 derivatives of \$292 million for the year ended December 2010 primarily was

attributable to changes in foreign exchange rates underlying certain currency derivatives.

Notes to Consolidated Financial Statements

Impact of Credit Spreads on Derivatives

On an ongoing basis, the Bank realizes gains or losses relating to changes in credit risk through the unwind of derivative contracts and changes in credit mitigants.

The net gain attributable to the impact of changes in credit exposure and credit spreads (of the Bank's counterparties as well as of the Bank or its affiliates) on derivatives was \$159 million and \$63 million for the years ended December 2011 and December 2010, respectively.

Derivatives with Credit-related Contingent Features

Certain of the Bank's derivatives have been transacted under bilateral agreements with counterparties who may require the Bank to post collateral or terminate the transactions based on changes in the credit ratings of the Bank or its affiliates. Typically, such requirements are based on the credit ratings of Group Inc. The table below presents the aggregate fair value of net derivative liabilities under such agreements (excluding application of collateral posted to reduce these liabilities), the related aggregate fair value of the assets posted as collateral, and the additional collateral or termination payments that could have been called at the reporting date by counterparties in the event of a one-notch and two-notch downgrade in the credit ratings of the Bank or its affiliates.

<i>in millions</i>	As of December	
	2011	2010
Net derivative liabilities under bilateral agreements	\$9,161	\$6,275
Collateral posted	7,055	4,615
Additional collateral or termination payments for a one-notch downgrade	386	182
Additional collateral or termination payments for a two-notch downgrade	542	514

Credit Derivatives

The Bank enters into a broad array of credit derivatives in locations around the world primarily to facilitate client transactions and to manage risk. Credit derivatives are actively managed based on the Bank's net risk position.

Credit derivatives are individually negotiated contracts and can have various settlement and payment conventions. Credit events include failure to pay, bankruptcy, acceleration of indebtedness, restructuring, repudiation and dissolution of the reference entity.

Credit Default Swaps. Single-name credit default swaps protect the buyer against the loss of principal on one or more bonds, loans or mortgages (reference obligations) in the event the issuer (reference entity) of the reference obligations suffers a credit event. The buyer of protection pays an initial or periodic premium to the seller and receives protection for the period of the contract. If there is no credit event, as defined in the contract, the seller of protection makes no payments to the buyer of protection. However, if a credit event occurs, the seller of protection is required to make a payment to the buyer of protection, which is calculated in accordance with the terms of the contract.

Credit Indices, Baskets and Tranches. Credit derivatives may reference a basket of single-name credit default swaps or a broad-based index. If a credit event occurs in one of the underlying reference obligations, the protection seller pays the protection buyer. The payment is typically a pro-rata portion of the transaction's total notional amount based on the underlying defaulted reference obligation. In certain transactions, the credit risk of a basket or index is separated into various portions (tranches), each having different levels of subordination. The most junior tranches cover initial defaults and once losses exceed the notional amount of these junior tranches, any excess loss is covered by the next most senior tranche in the capital structure.

Total Return Swaps. A total return swap transfers the risks relating to economic performance of a reference obligation from the protection buyer to the protection seller. Typically, the protection buyer receives from the protection seller a floating rate of interest and protection against any reduction in fair value of the reference obligation, and in return the protection seller receives the cash flows associated with the reference obligation, plus any increase in the fair value of the reference obligation.

Credit Options. In a credit option, the option writer assumes the obligation to purchase or sell a reference obligation at a specified price or credit spread. The option purchaser buys the right, but not the obligation, to sell the reference obligation to, or purchase it from, the option writer. The payments on credit options depend either on a particular credit spread or the price of the reference obligation.

Notes to Consolidated Financial Statements

The Bank economically hedges its exposure to written credit derivatives primarily by entering into offsetting purchased credit derivatives with identical underlyings. Substantially all of the Bank's purchased credit derivative transactions are with financial institutions and are subject to stringent collateral thresholds. In addition, upon the occurrence of a specified trigger event, the Bank may take possession of the reference obligations underlying a particular written credit derivative, and consequently may, upon liquidation of the reference obligations, recover amounts on the underlying reference obligations in the event of default.

As of December 2011, written and purchased credit derivatives had total gross notional amounts of \$203.72 billion and \$296.02 billion, respectively, for total net notional purchased protection of \$92.30 billion. As of December 2010, written and purchased credit derivatives had total gross notional amounts of \$195.66 billion and

\$289.67 billion, respectively, for total net notional purchased protection of \$94.01 billion.

The table below presents certain information about credit derivatives. In the table below:

- fair values exclude the effects of both netting under enforceable netting agreements and netting of cash received or posted under credit support agreements, and therefore are not representative of the Bank's exposure;
- tenor is based on remaining contractual maturity; and
- the credit spread on the underlying, together with the tenor of the contract, are indicators of payment/performance risk. The Bank is less likely to pay or otherwise be required to perform where the credit spread and the tenor are lower.

	Maximum Payout/Notional Amount of Written Credit Derivatives by Tenor				Maximum Payout/Notional Amount of Purchased Credit Derivatives		Fair Value of Written Credit Derivatives		Net Asset/ (Liability)
	0 - 12 Months	1 - 5 Years	5 Years or Greater	Total	Offsetting Purchased Credit Derivatives ¹	Other Purchased Credit Derivatives ²	Asset	Liability	
<i>\$ in millions</i>									
As of December 2011									
Credit spread on underlying (basis points)									
0-250	\$35,679	\$76,315	\$6,383	\$118,377	\$107,403	\$68,571	\$1,993	\$1,581	\$ 412
251-500	4,816	28,285	2,575	35,676	33,196	18,183	217	1,402	(1,185)
501-1,000	4,681	20,056	442	25,179	21,491	14,467	63	1,202	(1,139)
Greater than 1,000	6,290	17,879	322	24,491	22,697	10,011	55	5,836	(5,781)
Total	\$51,466	\$142,535	\$9,722	\$203,723	\$184,787	\$111,232	\$2,328	\$10,021	\$(7,693)
As of December 2010									
Credit spread on underlying (basis points)									
0-250	\$27,032	\$102,587	\$10,720	\$140,339	\$135,646	\$76,383	\$4,550	\$1,019	\$ 3,531
251-500	2,138	22,069	4,425	28,632	26,413	14,752	906	590	316
501-1,000	3,008	15,145	918	19,071	18,865	6,551	352	448	(96)
Greater than 1,000	1,330	5,920	367	7,617	6,862	4,201	67	3,715	(3,648)
Total	\$33,508	\$145,721	\$16,430	\$195,659	\$187,786	\$101,887	\$5,875	\$5,772	\$ 103

1. Offsetting purchased credit derivatives represent the notional amount of purchased credit derivatives to the extent they economically hedge written credit derivatives with identical underlyings.
2. This purchased protection represents the notional amount of purchased credit derivatives in excess of the notional amount included in "Offsetting Purchased Credit Derivatives."

Notes to Consolidated Financial Statements**Hedge Accounting**

The Bank applies hedge accounting for interest rate swaps used to manage the interest rate exposure of certain fixed-rate certificates of deposit.

To qualify for hedge accounting, the derivative hedge must be highly effective at reducing the risk from the exposure being hedged. Additionally, the Bank must formally document the hedging relationship at inception and test the hedging relationship at least on a quarterly basis to ensure the derivative hedge continues to be highly effective over the life of the hedging relationship.

Interest Rate Hedges

The Bank designates certain interest rate swaps as fair value hedges. These interest rate swaps hedge changes in fair value attributable to the relevant benchmark interest rate (e.g., London Interbank Offered Rate (LIBOR)), effectively converting a substantial portion of fixed-rate obligations into floating-rate obligations.

The Bank applies the “long-haul method” in assessing the effectiveness of its fair value hedging relationships in achieving offsetting changes in the fair values of the hedging instrument and the risk being hedged (i.e., interest rate risk).

An interest rate swap is considered highly effective in offsetting changes in fair value attributable to changes in the hedged risk when the regression analysis results in a coefficient of determination of 80% or greater and a slope between 80% and 125%.

For qualifying fair value hedges, gains or losses on derivatives are included in “Interest expense.” The change in fair value of the hedged item attributable to the risk being hedged is reported as an adjustment to its carrying value and is subsequently amortized into interest expense over its remaining life. Gains or losses resulting from hedge ineffectiveness are included in “Interest expense.” When a derivative is no longer designated as a hedge, any remaining difference between the carrying value and par value of the hedged item is amortized to interest expense over the remaining life of the hedged item using the effective interest method. See Note 22 for further information about interest income and interest expense.

For the years ended December 2011 and December 2010, the gain recognized on interest rate derivatives accounted for as hedges was \$18 million and \$74 million, respectively, and the related loss recognized on the hedged bank deposits was \$95 million and \$177 million, respectively. The hedge ineffectiveness recognized on these derivatives for the years ended December 2011 and December 2010 was a loss of \$77 million and \$105 million, respectively. The gain/(loss) excluded from the assessment of hedge effectiveness was not material for the years ended December 2011 and December 2010.

Notes to Consolidated Financial Statements

Note 8.

Fair Value Option

Other Financial Assets and Financial Liabilities at Fair Value

In addition to all cash and derivative instruments included in “Financial instruments owned, at fair value” and “Financial instruments sold, but not yet purchased, at fair value,” the Bank has elected to account for certain of its other financial assets and financial liabilities at fair value under the fair value option.

The primary reasons for electing the fair value option are to:

- reflect economic events in earnings on a timely basis;
- mitigate volatility in earnings from using different measurement attributes (e.g., transfers of financial instruments owned accounted for as financings are recorded at fair value whereas the related secured financing would be recorded on an accrual basis absent electing the fair value option); and
- address simplification and cost-benefit considerations.

Other financial assets and financial liabilities accounted for at fair value under the fair value option include:

- resale and repurchase agreements;
- certain other secured financings, primarily transfers of assets accounted for as financings rather than sales and debt raised through the Bank’s William Street credit extension program outstanding as of December 2010;
- certain other liabilities, primarily unsecured borrowings included in “Other liabilities and accrued expenses”; and
- certain time deposits. Deposits with no stated maturity are not eligible for a fair value option election.

These financial assets and financial liabilities at fair value are generally valued based on discounted cash flow techniques, which incorporate inputs with reasonable levels of price transparency, and are generally classified as level 2 because the inputs are observable. Valuation adjustments may be made for liquidity and for counterparty and the Bank’s credit quality.

Significant inputs for each category of other financial assets and financial liabilities at fair value are as follows:

Resale and Repurchase Agreements. The significant inputs to the valuation of resale and repurchase agreements are the amount and timing of expected future cash flows, interest rates and collateral funding spreads. See Note 9 for further information.

Other Secured Financings. The significant inputs to the valuation of other secured financings at fair value are the amount and timing of expected future cash flows, interest rates, the fair value of the collateral delivered by the Bank (which is determined using the amount and timing of expected future cash flows, market yields and recovery assumptions), the frequency of additional collateral calls and the credit spreads of the Bank or its affiliates. See Note 9 for further information.

Deposits. The significant inputs to the valuation of time deposits are interest rates. See Note 15 for further information.

Certain Other Liabilities. The significant inputs to the valuation of other liabilities that are recorded at fair value are the amount and timing of expected future cash flows, interest rates and the credit spreads of the Bank or its affiliates.

Notes to Consolidated Financial Statements

Fair Value of Other Financial Assets and Financial Liabilities by Level

The tables below present, by level within the fair value hierarchy, other financial assets and financial liabilities accounted for at fair value under the fair value option.

<i>in millions</i>	Other Financial Assets at Fair Value as of December 2011			
	Level 1	Level 2	Level 3	Total
Securities purchased under agreements to resell	\$ –	\$4,691	\$557	\$5,248

<i>in millions</i>	Other Financial Liabilities at Fair Value as of December 2011			
	Level 1	Level 2	Level 3	Total
Deposits	\$ –	\$ 2,166	\$ 13	\$ 2,179
Securities sold under agreements to repurchase	–	15,275	–	15,275
Other secured financings ¹	–	108	1	109
Other liabilities and accrued expenses ²	–	110	159	269
Total	\$ –	\$17,659	\$173	\$17,832

<i>in millions</i>	Other Financial Assets at Fair Value as of December 2010			
	Level 1	Level 2	Level 3	Total
Securities purchased under agreements to resell	\$ –	\$ 7,827	\$100	\$7,927

<i>in millions</i>	Other Financial Liabilities at Fair Value as of December 2010			
	Level 1	Level 2	Level 3	Total
Deposits	\$ –	\$ 850	\$ –	\$ 850
Securities sold under agreements to repurchase	–	9,180	–	9,180
Other secured financings ³	–	261	2,897	3,158
Other liabilities and accrued expenses ²	–	111	187	298
Total	\$ –	\$10,402	\$3,084	\$13,486

1. Primarily consists of transfers accounted for as financings rather than sales.
2. Primarily consists of unsecured borrowings.
3. Includes transfers accounted for as financings rather than sales and debt raised through the Bank's William Street credit extension program.

Notes to Consolidated Financial Statements

Level 3 Rollforward

If a financial asset or financial liability was transferred to level 3 during a reporting period, its entire gain or loss for the period is included in level 3. Transfers between levels are recognized at the beginning of the reporting period in which they occur. The tables below present changes in fair value for other financial assets and financial liabilities accounted for at fair value under the fair value option categorized as level 3 as of the end of the year.

Level 3 other financial assets and liabilities are frequently economically hedged with cash instruments and derivatives. Accordingly, gains or losses that are reported in level 3 can be partially offset by gains or losses attributable to level 1, 2 or 3 cash instruments or derivatives. As a result, gains or losses included in the level 3 rollforward below do not necessarily represent the overall impact on the Bank's results of operations, liquidity or capital resources.

Level 3 Other Financial Assets at Fair Value for the Year Ended December 2011

<i>in millions</i>	Balance, beginning of year	Net realized gains/(losses)	Net unrealized gains/(losses) relating to instruments still held at year-end	Purchases	Sales	Settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Securities purchased under agreements to resell	\$100	\$2	\$-	\$ 620	\$-	\$(165)	\$-	\$ 557

Level 3 Other Financial Liabilities at Fair Value for the Year Ended December 2011

<i>in millions</i>	Balance, beginning of year	Net realized (gains)/losses	Net unrealized (gains)/losses relating to instruments still held at year-end	Purchases	Sales	Issuances	Settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Deposits	\$ -	\$ -	\$ -	\$ -	\$ -	\$13	\$ -	\$ -	\$ 13
Other secured financings	2,897	11	-	-	-	-	(2,875) ²	(32)	1
Other liabilities and accrued expenses ¹	187	-	1	-	-	-	(28)	(1)	159
Total	\$3,084	\$11	\$ 1	\$-	\$-	\$13	\$(2,903)	\$(33)	\$173

Level 3 Other Financial Assets at Fair Value for the Year Ended December 2010

<i>in millions</i>	Balance, beginning of year	Net realized gains/(losses)	Net unrealized gains/(losses) relating to instruments still held at year-end	Net purchases, sales and settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Securities purchased under agreements to resell	\$ -	\$3	\$ -	\$97	\$ -	\$100

Level 3 Other Financial Liabilities at Fair Value for the Year Ended December 2010

<i>in millions</i>	Balance, beginning of year	Net realized (gains)/losses	Net unrealized (gains)/losses relating to instruments still held at year-end	Net purchases, sales, and settlements	Net transfers in and/or (out) of level 3	Balance, end of year
Other secured financings	\$3,107	\$ -	\$16	\$(226) ²	\$ -	\$2,897
Other liabilities and accrued expenses ¹	-	-	-	7	180	187
Total	\$3,107	\$ -	\$16	\$(219)	\$180	\$3,084

1. Primarily consists of unsecured borrowings.

2. Primarily related to principal repayments of secured debt raised through the Bank's William Street credit extension program.

Notes to Consolidated Financial Statements

Gains and Losses on Other Financial Assets and Financial Liabilities at Fair Value

The table below presents the gains and losses recognized as a result of the Bank electing to apply the fair value option to certain financial assets and financial liabilities. These gains and losses are included in “Gains and losses from financial instruments, net.”

The amounts in the table exclude contractual interest, which is included in “Interest income” and “Interest expense.” See Note 22 for further information about interest income and interest expense. The table also excludes gains/(losses) related to financial instruments owned, at fair value and financial instruments sold, but not yet purchased, at fair value.

<i>in millions</i>	Gains/Losses on Other Financial Assets and Liabilities at Fair Value	
	As of December	
	2011	2010
Other secured financings ¹	\$ –	\$(16) ³
Deposits	16	(8)
Other ²	2	6
Total	\$18	\$(18)

1. Excludes gains of \$7 million and \$40 million for the years ended December 2011 and December 2010, respectively, related to transfers of assets accounted for as financings rather than sales. These gains and losses are offset by gains and losses on the related financial instruments included in “Financial instruments owned, at fair value.”
2. Primarily consists of gains and losses on certain resale agreements.
3. Primarily relates to losses on long-term debt raised through the Bank’s William Street credit extension program.

Note 9.**Collateralized Agreements and Financings**

Collateralized agreements are securities purchased under agreements to resell (resale agreements or reverse repurchase agreements). Collateralized financings are securities sold under agreements to repurchase (repurchase agreements) and other secured financings. The Bank enters into these transactions in order to, among other things, facilitate client activities, invest excess cash, acquire securities to cover short positions, and finance certain Bank activities.

Collateralized agreements and financings are presented on a net-by-counterparty basis when a legal right of setoff exists. Interest on collateralized agreements and collateralized financings is recognized over the life of the transaction and included in “Interest income” and “Interest expense,” respectively. See Note 22 for further information about interest income and interest expense.

Resale and Repurchase Agreements

A resale agreement is a transaction in which the Bank purchases financial instruments from a seller, typically in exchange for cash, and simultaneously enters into an agreement to resell the same or substantially the same financial instruments to the seller at a stated price plus accrued interest at a future date.

A repurchase agreement is a transaction in which the Bank sells financial instruments to a buyer, typically in exchange for cash, and simultaneously enters into an agreement to repurchase the same or substantially the same financial instruments from the buyer at a stated price plus accrued interest at a future date.

The financial instruments purchased or sold in resale and repurchase agreements typically include U.S. government, federal agency and investment-grade sovereign obligations.

The Bank receives financial instruments purchased under resale agreements, makes delivery of financial instruments sold under repurchase agreements, monitors the market value of these financial instruments on a daily basis, and delivers or obtains additional collateral due to changes in the market value of the financial instruments, as appropriate. For resale agreements, the Bank typically requires delivery of collateral with a fair value approximately equal to the carrying value of the relevant assets in the consolidated statements of financial condition.

Notes to Consolidated Financial Statements

Even though repurchase and resale agreements involve the legal transfer of ownership of financial instruments, they are accounted for as financing arrangements because they require the financial instruments to be repurchased or resold at the maturity of the agreement. However, “repos to maturity” are accounted for as sales. A repo to maturity is a transaction in which the Bank transfers a security under an agreement to repurchase the security where the maturity date of the repurchase agreement matches the maturity date of the underlying security. Therefore, the Bank effectively no longer has a repurchase obligation and has relinquished control over the underlying security and, accordingly, accounts for the transaction as a sale. The Bank had no repos to maturity outstanding as of December 2011 or December 2010.

Other Secured Financings

In addition to repurchase agreements, the Bank funds certain assets through the use of other secured financings and pledges financial instruments and other assets as collateral in these transactions. As of December 2011, these other secured financings consist of transfers of financial assets accounted for as financings rather than sales (primarily bank loans and mortgage whole loans). Other secured financings also included debt raised through the Bank’s William Street credit extension program outstanding as of December 2010.

The Bank has elected to apply the fair value option to the following other secured financings because the use of fair value eliminates non-economic volatility in earnings that would arise from using different measurement attributes:

- transfers of assets accounted for as financings rather than sales; and
- debt raised through the Bank’s William Street credit extension program outstanding as of December 2010

See Note 8 for further information about other secured financings that are accounted for at fair value. Other secured financings that are not recorded at fair value are recorded based on the amount of cash received plus accrued interest, which generally approximates fair value.

As of December 2011 and December 2010, other secured financings included \$209 million and \$393 million, respectively, related to transfers of financial assets accounted for as financings rather than sales. Such

financings were collateralized by financial assets included in “Financial instruments owned, at fair value.” Of the \$209 million in other secured financings outstanding as of December 2011, \$194 million had a contractual maturity of one year or less.

As of December 2011 and December 2010, respectively, the aggregate contractual principal amount of other secured financings for which the fair value option was elected approximated their fair value.

Collateral Received and Pledged

The Bank receives financial instruments (e.g., U.S. government and federal agency, other sovereign and corporate obligations) as collateral, primarily in connection with resale agreements, derivative transactions and customer margin loans.

In many cases, the Bank is permitted to deliver or repledge these financial instruments when entering into repurchase agreements or collateralizing derivative transactions.

The table below presents financial instruments at fair value received as collateral that were available to be delivered or repledged and were delivered or repledged by the Bank.

<i>in millions</i>	As of December	
	2011	2010
Collateral available to be delivered or repledged	\$20,258	\$22,890
Collateral that was delivered or repledged	18,297	22,110

The Bank also pledges certain financial instruments owned, at fair value in connection with repurchase agreements, as well as other assets (primarily loans receivable), in connection with other secured financings to counterparties who may or may not have the right to deliver or repledge them. The table below presents information about assets pledged by the Bank.

<i>in millions</i>	As of December	
	2011	2010
Financial instruments owned, at fair value, pledged to counterparties that:		
Had the right to deliver or repledge	\$5,345	\$6,810
Did not have the right to deliver or repledge	102	4,420
Other assets pledged to counterparties that:		
Did not have the right to deliver or repledge	1,800	180

Notes to Consolidated Financial Statements

Note 10.

Securitization Activities

The Bank transfers portfolios of commercial mortgages to its affiliates for purposes of securitization. The Bank records a transfer as a sale when it has relinquished control over the transferred assets. The Bank accounts for transferred assets at fair value prior to the transfer and therefore does not typically recognize significant gains or losses upon the transfer of assets.

The Bank generally receives cash in exchange for the transferred assets but may also have continuing involvement with transferred assets in the form of loan servicing rights that the Bank retains at the time of securitization. Beneficial interests from the Bank's continuing involvement are accounted for at fair value and are included in "Financial instruments owned, at fair value" and are generally classified in level 2 of the fair value hierarchy. See Notes 5 through 8 for further information about fair value measurements.

During the years ended December 2011 and December 2010, the Bank did not transfer any assets in which it had continuing involvement. Cash flows received on retained interests were immaterial for the year ended December 2011. Cash flows received on retained interests were \$26 million for the year ended December 2010.

The table below presents the Bank's continuing involvement in transferred assets, as well as the related outstanding principal amounts. In this table:

- the outstanding principal amount is presented for the purpose of providing information about the size of the securitization entities in which the Bank has continuing involvement and is not representative of the Bank's risk of loss; and
- for retained interests, the Bank's risk of loss is limited to the fair value of these interests.

<i>in millions</i>	As of December 2011		As of December 2010	
	Outstanding Principal Amount	Fair Value of Retained Interests	Outstanding Principal Amount	Fair Value of Retained Interests
Residential mortgage-backed	\$ –	\$ –	\$7,163	\$17
Other asset-backed	–	–	125	–
Total ¹	\$ –	\$ –	\$7,288	\$17

1. The Bank's only continuing involvement in these entities is retained servicing which is not a variable interest.

Notes to Consolidated Financial Statements

Note 11.

Variable Interest Entities

VIEs generally finance the purchase of assets by issuing debt and equity securities that are either collateralized by or indexed to the assets held by the VIE. The debt and equity securities issued by a VIE may include tranches of varying levels of subordination. See Note 3 for the Bank's consolidation policies, including the definition of a VIE.

As described in Note 10, the Bank retains interests, in the form of servicing rights, in financial assets sold to VIEs in connection with securitization activities. In addition, the Bank makes investments in and loans to VIEs that hold real estate, distressed loans, and power-related assets. The Bank also utilizes VIEs to provide investors with principal-protected, credit-linked and asset-repackaged notes designed to meet their objectives.

VIE Consolidation Analysis

A variable interest in a VIE is an investment (e.g., debt or equity securities) or other interest (e.g., derivatives or loans and lending commitments) in a VIE that will absorb portions of the VIE's expected losses or receive portions of the VIE's expected residual returns.

The Bank's variable interests in VIEs include loan commitments; interest rate, foreign currency and credit derivatives; and guarantees.

The enterprise with a controlling financial interest in a VIE is known as the primary beneficiary and consolidates the VIE. The Bank determines whether it is the primary beneficiary of a VIE by performing an analysis that principally considers:

- which variable interest holder has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance;
- which variable interest holder has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE;
- the VIE's purpose and design, including the risks the VIE was designed to create and pass through to its variable interest holders;
- the VIE's capital structure;

- the terms between the VIE and its variable interest holders and other parties involved with the VIE; and
- related-party relationships.

The Bank reassesses its initial evaluation of whether an entity is a VIE when certain reconsideration events occur. The Bank reassesses its determination of whether it is the primary beneficiary of a VIE on an ongoing basis based on current facts and circumstances.

Nonconsolidated VIEs

The Bank's exposure to the obligations of VIEs is generally limited to its interests in these entities. In certain instances, the Bank provides guarantees, including derivative guarantees, to VIEs or holders of variable interests in VIEs.

The tables below present information about nonconsolidated VIEs in which the Bank holds variable interests. Nonconsolidated VIEs are aggregated based on principal business activity. The nature of the Bank's variable interests can take different forms, as described in the rows under maximum exposure to loss. In the tables below:

- The maximum exposure to loss excludes the benefit of offsetting financial instruments that are held to mitigate the risks associated with these variable interests.
- For loans and investments, the maximum exposure to loss is the carrying value of these interests.
- For commitments and guarantees, and derivatives the maximum exposure to loss is the notional amount, which does not represent anticipated losses and also has not been reduced by unrealized losses already recorded. As a result, the maximum exposure to loss exceeds liabilities recorded for commitments and guarantees, and derivatives provided to VIEs.

All assets held by the Bank related to its variable interests in nonconsolidated VIEs are included in "Financial instruments owned, at fair value."

Notes to Consolidated Financial Statements

<i>in millions</i>	Nonconsolidated VIEs				
	As of December 2011				
	Mortgage and other asset-backed	Corporate bonds	Real estate, credit-related and other investing	Power-related	Total
Assets in VIE	\$2,681 ¹	\$108	\$834	\$18	\$3,641
Carrying Value of the Bank's Variable Interests					
Assets	241	11	180	–	432
Liabilities	–	–	–	–	–
Maximum Exposure to Loss					
Commitments and guarantees	–	–	107	37	144
Derivatives	2,640 ²	107	372	–	3,119
Loans and investments	–	–	124	–	124
Total	\$2,640	\$107	\$603	\$37	\$3,387

<i>in millions</i>	Nonconsolidated VIEs				
	As of December 2010				
	Mortgage and other asset-backed	Corporate bonds	Real estate, credit-related and other investing	Power-related	Total
Assets in VIE	\$3,388 ¹	\$411	\$271	\$70	\$4,140
Carrying Value of the Bank's Variable Interests					
Assets	258	22	70	–	350
Liabilities	–	–	–	1	1
Maximum Exposure to Loss					
Beneficial and purchased interests	13	–	–	–	13
Commitments and guarantees	–	–	62	37	99
Derivatives	2,307 ²	437	–	–	2,744
Loans and investments	–	–	70	–	70
Total	\$2,320	\$437	\$132	\$37	\$2,926

1. Relates to CDOs backed by residential mortgage obligations.

2. Primarily consists of written protection on investment-grade, short-term collateral held by VIEs that have issued CDOs.

Notes to Consolidated Financial Statements

Note 12. Loans

Loans at Fair Value

Loans for which the Bank has elected the fair value option and which are managed on a fair value basis are included in “Financial instruments owned, at fair value.” See Note 6 for a discussion of the techniques and significant inputs used in the valuation of loans. The table below presents the components of loans held at fair value:

<i>in millions</i>	As of December	
	2011	2010
Consumer loans	\$ 39	\$ 31
Commercial loans	7,133	3,236
Mortgage loans	2,430	1,769
Other loans	15	–
Total	\$9,617	\$5,036

The aggregate contractual principal amount of loans for which the fair value option was elected exceeded the related fair value by \$930 million and \$508 million as of December 2011 and December 2010. Included in these amounts are loans in non-accrual status (including loans more than 90 days past due) with a principal balance of \$6 million and \$426 million and a fair value of \$3 million and \$29 million as of December 2011 and December 2010, respectively. The aggregate contractual principal exceeds the related fair value primarily due to current conditions in credit markets.

Loans Receivable, net

Loans carried at principal less an allowance for loan losses are classified as “Loans receivable, net.” Such loans are placed on non-accrual status if principal or interest is past due on a contractual basis of 90 days or more. At that time, all accrued but unpaid interest is reversed against interest income. All loans greater than 90 days past due and other loans exhibiting credit quality weakness are evaluated individually for impairment. A loan is determined to be impaired when it is probable that the Bank will not be able to collect all principal and interest due under the contractual terms of the loan. The Bank writes off those loan amounts it considers uncollectible.

The allowance for loan losses is determined using various assumptions, including industry experience and delinquency and loss trends. The allowance is an amount which management believes is adequate to absorb losses inherent in the portfolio that can be reasonably estimated. Management’s estimate of loan losses entails considerable

judgment about loan collectability based on available information at the reporting dates, and the uncertainties inherent in those assumptions. While management uses the best information available to determine this estimate, future adjustments to the allowance may be necessary based on changes in the economic environment or variances between actual results and the original assumptions used. The allowance for loan losses is reported as a reduction to the loans receivable balance to arrive at loans receivable, net of allowance for loan losses.

The table below presents the components of loans carried at principal, net of allowance for loan losses:

<i>in millions</i>	As of December	
	2011	2010
Consumer loans	\$ 341	\$ 189
Commercial loans	909	873
Loans to purchase or carry securities	271	233
Other loans	1,581	1,114
	3,102	2,409
Allowance for loan losses	(6)	(4)
Total	\$3,096	\$2,405

The carrying amount of loans receivable, net approximates fair value as these are primarily variable rate loans that reset frequently and have no material change in credit quality. Such loans are typically fully collateralized by tangible assets, financial instruments, or a combination thereof. There were no loans receivable in non-accrual status at December 2011 or December 2010.

Impact of Credit Spreads on Loans and Lending Commitments

The estimated impact of changes in instrument-specific credit spreads on loans and loan commitments for which the fair value option was elected was a loss of \$1.01 billion and a gain of \$222 million for the years ended December 2011 and December 2010, respectively. The Bank attributes changes in the fair value of floating rate loans and loan commitments to changes in instrument-specific credit spreads. Substantially all of the Bank’s loans and lending commitments are floating-rate.

Notes to Consolidated Financial Statements

Note 13.

Sale of Litton

During 2011, the Bank classified certain assets and liabilities as held for sale, related to Litton, the Bank's residential mortgage servicing subsidiary, which was sold on September 1, 2011. In connection with the held-for-sale designation, the Bank recognized impairment losses of approximately \$166 million (\$154 million related to goodwill and \$12 million related to intangible assets). These impairment losses, which are included in "Other expenses," represent the excess of (i) the carrying value of the net assets held for sale over (ii) their estimated fair value less estimated cost to sell. On September 1, 2011, Litton's assets and liabilities consisted primarily of servicing advances of \$2.47 billion and a loan facility payable to Goldman Sachs Bank USA of \$2.42 billion. Upon the sale of Litton, the Bank received total consideration which approximated the Bank's carrying value at date of sale.

In connection with the sale, Group Inc. has, to the extent permitted by law, agreed to reimburse the Bank for all future financial liabilities and costs associated with Litton's activities. As of the date of sale, the fair value of such liabilities and costs was \$125 million, for which the Bank has recorded a non-cash capital contribution from Group Inc. See Notes 18 and 21 for further discussion of the liabilities assumed by Group Inc.

The net revenues of Litton were \$128 million and \$207 million from January 1, 2011 through the date of sale and for the year ended December 2010, respectively. Total expenses, net of a benefit for income taxes, were \$157 million and \$237 million, from January 1, 2011 through the date of sale and for the year ended December 2010, respectively.

Note 14.

Other Assets

Other assets are generally less liquid in nature. The table below presents other assets by type.

<i>in millions</i>	As of December	
	2011	2010
Receivable from affiliates ¹	\$ 553	\$ 864
Federal Reserve Board shares	409	399
Income tax-related assets ²	246	229
Prepaid FDIC fees	135	196
Other	78	249 ³
Total	\$1,421	\$1,937

1. See Note 21 for further information about related party transactions.
2. See Note 24 for further information about income taxes.
3. Includes goodwill of \$154 million related to Litton. See Note 13 for further information about the sale of Litton.

Notes to Consolidated Financial Statements

Note 15.

Deposits

The table below presents the Bank's deposits by type:

<i>in millions</i>	As of December	
	2011	2010
Savings	\$33,911	\$24,838
Time	10,919	7,520
Demand	— ¹	15
Total	\$44,830	\$32,373

1. The Bank maintained an immaterial amount of demand deposits.

Savings accounts are comprised of money market deposit accounts (MMDA) and negotiable order of withdrawal accounts (NOW). MMDA and NOW are interest-bearing accounts that have no maturity or expiration date. The depositor may be required by the Bank to give written notice of intended withdrawals not less than seven days before such withdrawals are made. The carrying amount of savings deposits approximates fair value due to frequent repricing of these deposits.

Time deposits consist primarily of brokered certificates of deposit which have stipulated maturity dates and rates of interest. Early withdrawals of time deposits are generally prohibited.

The Bank's time deposits by contractual maturity are as follows:

<i>in millions</i>	As of December 2011
2012	\$2,487
2013	3,252
2014	1,306
2015	1,031
2016	723
2017 – thereafter	2,120
Total¹	\$10,919

1. Includes \$71 million greater than \$100,000, of which \$4 million matures within three months, \$2 million matures within three to six months, \$35 million matures within six to twelve months, and \$30 million matures after twelve months.

The table below presents the balances of time deposits accounted for under a fair value option:

<i>in millions</i>	As of December			
	2011		2010	
	Principal	Fair Value	Principal	Fair Value
Maturity				
< 1 year	\$1,801	\$1,813	\$221	\$222
Maturity >				
1 year	336	366	632	628
Total	\$2,137	\$2,179	\$853	\$850

The balances of time deposits accounted for under hedge accounting was \$8.74 billion and \$6.67 billion as of December 2011 and December 2010, respectively. Refer to Note 7 for further information about hedge accounting.

Demand deposit accounts (DDA) are non-interest bearing accounts that have no maturity or expiration date and are not subject to restrictions with respect to the timing and number of transactions that deposit holders may execute. The fair value of DDA accounts is the amount payable on demand at the reporting date.

Notes to Consolidated Financial Statements

Note 16.

Subordinated Borrowings

The Bank has an \$8.00 billion revolving subordinated loan agreement with Group Inc, which matures in 2018. At December 2011, there are no outstanding subordinated borrowings with Group Inc. under the agreement. As of December 2010, subordinated borrowings were \$5.00 billion (the carrying value of the borrowings approximated fair value). Amounts borrowed under this agreement bear interest at a rate of Federal funds rate plus 3.5% per annum. Any amounts payable under the agreement would be subordinate to the claims of certain other creditors of the Bank, including depositors and regulatory agencies.

Note 17.

Other Liabilities and Accrued Expenses

The table below presents other liabilities and accrued expenses by type.

<i>in millions</i>	As of December	
	2011	2010
Income tax-related liabilities ¹	\$ 975	\$ 563
Unsecured borrowings ^{2,3}	912	335
Accrued expenses and other	360	452
Total	\$2,247	\$1,350

1. See Note 24 for further information about income taxes.
2. Consists primarily of derivative contracts with a financing element and unsecured borrowings from affiliates.
3. Includes \$653 million and \$91 million of borrowings with a maturity greater than one year as of December 2011 and December 2010, respectively.

Notes to Consolidated Financial Statements

Note 18.

Commitments, Contingencies and Guarantees

Commitments

The table below presents the Bank's commitments.

<i>in millions</i>	Commitment Amount by Period of Expiration as of December 2011				Total Commitments as of December	
	2012	2013- 2014	2015- 2016	2017- Thereafter	2011	2010
Commitments to extend credit ¹						
Commercial lending:						
Investment-grade	\$ 5,028	\$ 4,266	\$ 8,890	\$ 25	\$18,209	\$ 9,858
Non-investment-grade	793	1,740	5,046	245	7,824	6,096
William Street credit extension program	5,398	5,593	17,998	143	29,132	25,544
Warehouse financing	58	189	–	–	247	298
Total commitments to extend credit	11,277	11,788	31,934	413	55,412	41,796
Contingent and forward starting resale agreements ²	298	–	–	–	298	326
Forward starting repurchase agreements ²	34	–	–	–	34	164
Letters of credit ³	87	25	–	–	112	113
Investment commitments	–	–	–	84	84	96
Other	602	–	–	–	602	549
Total commitments	\$12,298	\$11,813	\$31,934	\$497	\$56,542	\$43,044

1. Commitments to extend credit are presented net of amounts syndicated to third parties.
2. These agreements generally settle within three days.
3. Consists of commitments under letters of credit issued by various banks which the Bank provides to counterparties.

Commitments to Extend Credit

The fair value of commitments accounted for at fair value was a liability of \$1.80 billion and \$754 million as of December 2011 and December 2010, respectively. To the extent that the Bank recognizes losses on these commitments, such losses are recorded within "Gains and losses from financial instruments, net," net of any related underwriting fees. There was no allowance for off-balance sheet commitments as of December 2011 or December 2010.

The Bank's commitments to extend credit are agreements to lend with fixed termination dates and depend on the satisfaction of all contractual conditions to borrowing. The total commitment amount does not necessarily reflect actual future cash flows because the Bank may syndicate all or substantial portions of these commitment and commitments can expire unused or be reduced or cancelled at the counterparty's request.

Commercial Lending. The Bank's commercial lending commitments are generally extended in connection with contingent acquisition financing and other types of corporate lending as well as commercial real estate financing. Commitments that are extended for contingent acquisition financing are often intended to be short-term in nature, as borrowers often seek to replace them with other funding sources.

William Street Credit Extension Program.

Substantially all of the commitments provided under the William Street credit extension program are to investment-grade corporate borrowers. Certain commitments under the program were extended by Commitment Corp. Historically, commitments extended by Commitment Corp. were supported, in part, by funding raised by Funding Corp. As of April 26, 2011, the funding raised by Funding Corp. had been repaid in its entirety. The commitments extended by Commitment Corp. as well as new commitments extended by Goldman Sachs Bank USA are now supported by other sources of Bank funding.

Notes to Consolidated Financial Statements

The assets and liabilities of Commitment Corp. are legally separated from other assets and liabilities of the Bank. The assets of Commitment Corp. will not be available to its shareholders until the claims of its creditors have been paid. In addition, no affiliate of Commitment Corp., except in limited cases as expressly agreed in writing, is responsible for any obligation of Commitment Corp.

Sumitomo Mitsui Financial Group Inc. (SMFG) provides the Bank with credit loss protection that is generally limited to 95% of the first loss the Bank realizes on approved loan commitments, up to a maximum of approximately \$950 million, with respect to most of the William Street commitments. In addition, subject to the satisfaction of certain conditions, upon the Bank's request, SMFG will provide protection for 70% of additional losses on such commitments, up to a maximum of \$1.13 billion, of which \$300 million and \$375 million of protection had been provided as of December 2011 and December 2010, respectively. The Bank also uses other financial instruments to mitigate credit risks related to certain William Street commitments not covered by SMFG.

Warehouse Financing. The Bank provides financing to clients who warehouse financial assets. These arrangements are secured by the warehoused assets, primarily consisting of commercial mortgages.

Contingent and Forward Starting Resale Agreements/Forward Starting Repurchase Agreements. The Bank enters into resale agreements and repurchase agreements that settle at a future date. The Bank also enters into commitments to provide contingent financing to its clients through resale agreements. The Bank's funding of these commitments depends on the satisfaction of all contractual conditions to the resale agreement and these commitments can expire unused.

Investment Commitments. The Bank's investment commitments consist of commitments to invest in private equity, real estate and other assets.

Contingencies

Legal Proceedings. See Note 19 for information on legal proceedings.

Certain Mortgage-Related Contingencies. There are multiple areas of focus by regulators, governmental agencies and others within the mortgage market that may impact originators, issuers, servicers and investors. There remains significant uncertainty surrounding the nature and extent of any potential exposure for participants in this market.

- **Representations and Warranties.** Substantially all of the activity described below, with respect to representations and warranties, occurred prior to the reorganization of the Bank. Any losses incurred within the entities contributed during the reorganization are thus reimbursed under the Guarantee (see Notes 1 and 21 for additional information as to the Guarantee). As such there will not be an impact to the continuing operations or results of the Bank with respect to these matters.

The Bank has not been a significant originator of residential mortgage loans. The Bank did purchase loans originated by others and generally received loan level representations of the type described below from the originators. During the period 2005 through 2008, the Bank sold approximately \$10 billion of loans to government-sponsored enterprises and approximately \$11 billion of loans to other third parties. In addition, the Bank transferred loans to trusts and other mortgage securitization vehicles. As of December 2011 and December 2010, the outstanding balance of the loans transferred to trusts and other mortgage securitization vehicles during the period 2005 through 2008 was approximately \$42 billion and \$49 billion, respectively. This amount reflects paydowns and cumulative losses of approximately \$83 billion (\$17 billion of which are cumulative losses) as of December 2011 and approximately \$76 billion (\$14 billion of which are cumulative losses) as of December 2010. A small number of these Goldman Sachs-issued securitizations with an outstanding principal balance of \$635 million and total paydowns and cumulative losses of \$1.42 billion (\$465 million of which were cumulative losses) as of December 2011, and an outstanding principal balance of \$739 million and total paydowns and cumulative losses of \$1.32 billion (\$410 million of which are cumulative losses) as of December 2010, were structured with credit protection obtained from monoline insurers. In connection

Notes to Consolidated Financial Statements

with both sales of loans and securitizations, the Bank provided loan level representations of the type described below and/or assigned the loan level representations from the party from whom the Bank purchased the loans.

The loan level representations made in connection with the sale or securitization of mortgage loans varied among transactions but were generally detailed representations applicable to each loan in the portfolio and addressed matters relating to the property, the borrower and the note. These representations generally included, but were not limited to, the following: (i) certain attributes of the borrower's financial status; (ii) loan-to-value ratios, owner occupancy status and certain other characteristics of the property; (iii) the lien position; (iv) the fact that the loan was originated in compliance with law; and (v) completeness of the loan documentation.

To date, repurchase claims and actual repurchases of residential mortgage loans based upon alleged breaches of representations have not been significant and have mainly involved government sponsored enterprises. During the year ended December 2011, the Bank repurchased loans with an unpaid principal balance of less than \$10 million. During the year ended December 2010, the Bank repurchased loans with an unpaid principal balance of less than \$50 million. The loss related to the repurchase of these loans incurred by the Bank was reimbursed under the Guarantee for the years ended December 2011 and December 2010.

Ultimately, the Bank's exposure to claims for repurchase of residential mortgage loans based on alleged breaches of representations will depend on a number of factors including the following: (i) the extent to which these claims are actually made; (ii) the extent to which there are underlying breaches of representations that give rise to valid claims for repurchase; (iii) in the case of loans originated by others, the extent to which the Bank could be held liable and, if it is, the Bank's ability to pursue and collect on any claims against the parties who made representations to the Bank; (iv) macro-economic factors, including developments in the residential real estate market; and (v) legal and regulatory developments.

Based upon the large number of defaults in residential mortgages, including those sold or securitized by the Bank, there is a potential for increasing claims for repurchases. However, the Bank is not in a position to make a meaningful estimate of that exposure at this time.

- Foreclosure and Other Mortgage Loan Servicing Practices and Procedures.** Losses arising from the foreclosure and other mortgage loan servicing practices and procedures described below, have been reimbursed by Group Inc. See Note 13 for additional information as to the Group Inc. reimbursement.

The Bank had received a number of requests for information from regulators and other agencies, including state attorneys general and banking regulators, as part of an industry-wide focus on the practices of lenders and servicers in connection with foreclosure proceedings and other aspects of mortgage loan servicing practices and procedures. The requests sought information about the foreclosure and servicing protocols and activities of Litton, which was sold by the Bank to a third-party purchaser in the third quarter of 2011. The Bank is cooperating with the requests and these inquiries may result in the imposition of fines or other regulatory action. In the third quarter of 2010, prior to the Bank's sale of Litton, Litton had temporarily suspended evictions and foreclosure and real estate owned sales in a number of states, including those with judicial foreclosure procedures. Litton resumed these activities beginning in the fourth quarter of 2010. In connection with the sale of Litton, the Bank agreed to provide certain representations and warranties, and specific indemnities related to Litton's servicing and foreclosure practices prior to the close of the sale. The liability associated with certain of these indemnities has been capped. For indemnities not subject to a cap, management is unable to develop an estimate of the maximum potential amount of future payments because no amounts have yet been specified or claimed. However, management does not believe, based on currently available information, that any payments under these indemnities will have a material adverse effect on the Bank's financial condition.

On September 1, 2011, Group Inc. and the Bank entered into a Consent Order (the Order) with the Federal Reserve Board relating to the servicing of residential mortgage loans. The terms of the Order are substantially similar and, in many respects, identical to the orders entered into with the Federal Reserve Board by other large U.S. financial institutions. The Order sets forth various allegations of improper conduct in servicing by Litton, requires that Group Inc. and the Bank cease and desist such conduct, and requires that Group Inc. and the Bank, and their boards of directors, take various affirmative steps. The Order requires (i) Group Inc. and the Bank to

Notes to Consolidated Financial Statements

engage a third-party consultant to conduct a review of certain foreclosure actions or proceedings that occurred or were pending between January 1, 2009 and December 31, 2010; (ii) the adoption of policies and procedures related to management of third parties used to outsource residential mortgage servicing, loss mitigation or foreclosure; (iii) a "validation report" from an independent third-party consultant regarding compliance with the Order for the first year; and (iv) submission of quarterly progress reports as to compliance with the Order by the boards of directors (or committees thereof) of Group Inc. and the Bank.

In addition, on September 1, 2011, the Bank entered into an Agreement on Mortgage Servicing Practices with the New York State Banking Department, Litton and the acquirer of Litton relating to the servicing of residential mortgage loans, and, in a related agreement with the New York State Banking Department, Group Inc. agreed to forgive 25% of the unpaid principal balance on certain delinquent first lien residential mortgage loans owned by Group Inc. or a subsidiary, totaling approximately \$13 million in principal forgiveness.

Guarantees

The Bank enters into various derivatives that meet the definition of a guarantee under U.S. GAAP, including written currency contracts, and interest rate caps, floors and swaptions. Disclosures about derivatives are not required if they may be cash settled and the Bank has no basis to conclude it is probable that the counterparties held the underlying instruments at inception of the contract. The Bank has concluded that these conditions have been met for certain large, internationally active commercial and investment bank counterparties and certain other counterparties. Accordingly, the Bank has not included such contracts in the tables below.

The Bank, in its capacity as an agency lender, indemnifies most of its securities lending customers against losses incurred in the event that borrowers do not return securities and the collateral held is insufficient to cover the market value of the securities borrowed.

In the ordinary course of business, the Bank provides other financial guarantees of the obligations of third parties (e.g., standby letters of credit and other guarantees to enable clients to complete transactions). These guarantees represent obligations to make payments to beneficiaries if the guaranteed party fails to fulfill its obligation under a contractual arrangement with that beneficiary.

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The table below presents certain information about derivatives that meet the definition of a guarantee and certain other guarantees. The maximum payout in the table below is based on the notional amount of the contract and therefore does not represent anticipated losses. See Note 7 for further information about credit derivatives that meet the definition of a guarantee which are not included below.

Because derivatives are accounted for at fair value, the carrying value is considered the best indication of payment/performance risk for individual contracts. However, the carrying values below exclude the effect of a legal right of setoff that may exist under an enforceable netting agreement and the effect of netting of cash collateral posted under credit support agreements.

<i>in millions</i>	As of December 2011					
	Carrying Value of Net Liability	Maximum Payout/Notional Amount by Period of Expiration				
		2012	2013- 2014	2015- 2016	2017- Thereafter	Total
Derivatives ¹	\$2,045	\$37,347	\$18,700	\$ 9,549	\$3,346	\$ 68,942
Securities lending indemnifications ²	–	33,205	–	–	–	33,205
Other financial guarantees ³	63	523	420	1,119	840	2,902

1. These derivatives are risk managed together with derivatives that do not meet the definition of a guarantee under U.S. GAAP and therefore these amounts do not reflect the Bank's overall risk related to its derivative activities. As of December 2010, the carrying value of the net liability related to derivative guarantees was \$1.23 billion.
2. Collateral held by the lenders in connection with securities lending indemnifications was \$34.11 billion as of December 2011. Because the contractual nature of these arrangements requires the Bank to obtain collateral with a market value that exceeds the value of the securities lent to the borrower, there is minimal performance risk associated with these guarantees.
3. Other financial guarantees excludes certain commitments to issue standby letters of credit that are included in "Commitments to extend credit." See table in "Commitments" above for a summary of the Bank's commitments. As of December 2010, the carrying value of the net liability related to other financial guarantees was \$10 million.

Other Representations, Warranties and Indemnifications. The Bank provides representations and warranties to counterparties in connection with a variety of commercial transactions and occasionally indemnifies them against potential losses caused by the breach of those representations and warranties. The Bank may also provide indemnifications protecting against changes in or adverse application of certain U.S. tax laws in connection with ordinary-course transactions such as borrowings or derivatives.

These indemnifications generally are standard contractual terms and are entered into in the ordinary course of business. Generally, there are no stated or notional amounts included in these indemnifications, and the contingencies triggering the obligation to indemnify are not expected to occur. The Bank is unable to develop an estimate of the maximum payout under these guarantees and indemnifications. However, management believes that it is unlikely the Bank will have to make any material payments under these arrangements, and no liabilities related to these arrangements have been recognized in the consolidated statements of financial condition as of December 2011 and December 2010.

Notes to Consolidated Financial Statements

Note 19.

Legal Proceedings

The Bank is involved in a number of judicial, regulatory and other proceedings concerning matters arising in connection with the conduct of the Bank's businesses. Many of these proceedings are in early stages, and many of these cases seek an indeterminate amount of damages. For most such cases, however, the Bank expects that it would receive reimbursement from Group Inc. under the Guarantee agreement (see Notes 1 and 21).

Management is generally unable to estimate a range of reasonably possible loss for proceedings including where (i) plaintiffs have not claimed an amount of money damages, unless management can otherwise determine an appropriate amount, (ii) the proceedings are in early stages, (iii) there is

uncertainty as to the likelihood of a class being certified or the ultimate size of the class, (iv) there is uncertainty as to the outcome of pending appeals or motions, (v) there are significant factual issues to be resolved, and/or (vi) there are novel legal issues presented. However, for these cases, management does not believe, based on currently available information, that the outcomes of these proceedings will have a material adverse effect on the Bank's financial condition, though the outcomes could be material to the Bank's operating results for any particular period, depending, in part, upon the operating results for such period.

Notes to Consolidated Financial Statements

Note 20.

Regulation and Capital Adequacy

The Bank, an FDIC-insured, New York State-chartered bank and a member of the Federal Reserve System, is supervised and regulated by the Federal Reserve Board, the FDIC and the New York State Department of Financial Services (formerly the New York State Banking Department) and is subject to minimum capital requirements. In compliance with the Federal Reserve Board's regulatory capital guidelines applicable to state member banks and under the regulatory framework for prompt corrective action (PCA) that is applicable to the Bank, the Bank must meet specific capital requirements that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory reporting practices. The Bank's capital amounts, as well as the Bank's PCA classification, are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The Bank computes its capital ratios in accordance with the regulatory capital guidelines currently applicable to state member banks, which are based on Basel 1 as implemented by the Federal Reserve Board, for purposes of assessing the adequacy of its capital. In order to be considered a "well capitalized" depository institution under the PCA framework, the Bank must maintain a Tier 1 capital ratio of at least 6%, a total capital ratio of at least 10% and a Tier 1 leverage ratio of at least 5%. The Bank has agreed with the Federal Reserve Board to minimum capital ratios in excess of "well capitalized" levels. Accordingly, for a period of time, the Bank is expected to maintain a Tier 1 capital ratio of at least 8%, a total capital ratio of at least 11% and a Tier 1 leverage ratio of at least 6%.

Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

As noted in the table below, the Bank was in compliance with these minimum capital requirements as of December 2011 and December 2010.

The table below presents information about the Bank's regulatory capital ratios under Basel 1 as implemented by the Federal Reserve Board.

<i>\$ in millions</i>	As of December	
	2011	2010
Tier 1 capital	\$ 19,251	\$ 18,604
Tier 2 capital	6	5,004
Total capital	19,257	23,608
Risk-weighted assets	112,824	98,719
Tier 1 capital ratio	17.1%	18.8%
Total capital ratio	17.1% ¹	23.9%
Tier 1 leverage ratio	18.5%	19.5%

1. The decrease from December 2010 to December 2011 is primarily related to the Bank's repayment of \$5.00 billion of subordinated borrowings to Group Inc. and \$1.00 billion dividend to Group Inc. during 2011.

The deposits of the Bank are insured by the FDIC to the extent provided by law. The Federal Reserve Board requires depository institutions to maintain cash reserves with a Federal Reserve Bank. The amount deposited by the Bank at the Federal Reserve Bank was approximately \$40.06 billion and \$28.12 billion as of December 2011 and December 2010, respectively, which exceeded required reserve amounts by \$39.51 billion and \$27.45 billion as of December 2011 and December 2010, respectively.

Net assets of the Bank are restricted as to the payment of dividends to Group Inc. In addition to limitations on the payment of dividends imposed by federal and state laws, the Federal Reserve Board and the FDIC have authority to prohibit or limit the payment of dividends by the banking organizations they supervise if in their opinion, payment of a dividend would constitute an unsafe or unsound practice in light of the financial condition of the banking organization. As of December 2011 and December 2010, the Bank could have declared dividends of \$5.21 billion and \$4.63 billion, respectively, to Group Inc. The Bank paid dividends of \$1.00 billion during the year ended December 2011.

Notes to Consolidated Financial Statements

Regulatory Reform

The Bank is currently working to implement the requirements set out in the Federal Reserve Board's Risk-Based Capital Standards: Advanced Capital Adequacy Framework – Basel 2 (Basel 2), which are based on the advanced approaches under the Revised Framework for the International Convergence of Capital Measurement and Capital Standards issued by the Basel Committee on Banking Supervision (Basel Committee). U.S. banking regulators have incorporated the Basel 2 framework into the existing risk-based capital requirements by requiring that internationally active banking organizations, such as Group Inc., adopt Basel 2, once approved to do so by regulators. As a subsidiary of a banking organization that is required to adopt Basel 2, the Bank is also required to adopt Basel 2 once approved to do so by its regulators. As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), U.S. banking regulators have adopted a rule that requires large banking organizations, upon adoption of Basel 2, to continue to calculate risk-based capital ratios under both Basel 1 and Basel 2. For each of the Tier 1 and Total capital ratios, the lower of the Basel 1 and Basel 2 ratios calculated will be used to determine whether the bank meets its minimum risk-based capital requirements.

In December 2011, the U.S. federal bank regulatory agencies issued revised proposals to modify their market risk capital regulatory requirements for banking organizations in the United States that have significant trading activities. These modifications are designed to address the adjustments to the market risk framework that were announced by the Basel Committee in June 2010 (Basel 2.5), as well as the prohibition in the use of credit ratings, as required by the Dodd-Frank Act. Once implemented, it is likely that these changes will result in increased capital requirements for market risk.

Additionally, the Basel 3 guidelines issued by the Basel Committee in December 2010 revise the definition of Tier 1 capital, introduce Tier 1 common equity as a regulatory metric, set new minimum capital ratios (including a new "capital conservation buffer" which must be composed exclusively of Tier 1 common equity and will be in addition to the minimum capital ratios), introduce a Tier 1 leverage ratio within international guidelines for the first time, and make substantial revisions to the computation of risk-weighted assets for credit exposures. Implementation of the new requirements is expected to take place over the next several years. The federal banking agencies have not yet

proposed rules to implement the Basel 3 guidelines in the United States.

The Basel Committee has published its final provisions for assessing the global systemic importance of banking institutions and the range of additional Tier 1 common equity that should be maintained by banking institutions deemed to be globally systemically important. The additional capital for these institutions would initially range from 1% to 2.5% of Tier 1 common equity and could be as much as 3.5% for a bank that increases its systemic footprint (e.g., by increasing total assets). Group Inc. was one of 29 institutions identified by the Financial Stability Board (established at the direction of the leaders of the Group of 20) as globally systemically important under the Basel Committee's methodology. Therefore, depending upon the manner and timing of the U.S. banking regulators' implementation of the Basel Committee's methodology, Group Inc. expects that the minimum Tier 1 common ratio requirement applicable to Group Inc. will include this additional capital assessment. The final determination of whether an institution is classified as globally systemically important and the calculation of the required additional capital amount is expected to be disclosed by the Basel Committee no later than November 2014 based on data through the end of 2013. At this stage it is not known whether the Basel Committee's methodology for requiring higher capital requirements for globally systemically important banking institutions, will also be applied to individual banks such as the Bank.

The Federal Reserve Board has proposed regulations designed to strengthen the regulation and supervision of large bank holding companies and systemically important nonbank financial firms. These proposals address risk-based capital and leverage requirements, liquidity requirements, stress tests, single counterparty limits and early remediation requirements that are designed to address financial weakness at an early stage. Although many of the proposals mirror initiatives to which bank holding companies are already subject, their full impact on the Bank and its parent will not be known with certainty until the rules are finalized. However as proposed, the rule will require the Bank, as a state member bank with more than \$10 billion in total assets, to conduct annual stress tests under baseline, adverse and severely adverse scenarios provided by the Federal Reserve Board. Results summarizing the impact of the stress tests on the Bank's capital ratios must be publicly disclosed.

Notes to Consolidated Financial Statements

The Dodd-Frank Act directs banking regulators, among other things, to impose additional capital requirements, as discussed above. The Federal Reserve Board is expected to adopt the new leverage and risk-based capital regulations in 2012. The interaction among the Dodd-Frank Act, the Basel Committee's proposed changes and other proposed or announced changes from other governmental entities and regulators, adds further uncertainty to the Bank's future capital requirements.

As a consequence of these developments, the Bank expects minimum capital ratios required to be maintained under Federal Reserve Board regulations will be increased and changes in the prescribed calculation methodology are expected to result in higher risk weighted assets and lower capital ratios than those currently computed.

Notes to Consolidated Financial Statements

Note 21.

Transactions with Affiliates

Transactions between the Bank and Group Inc. and its subsidiaries and affiliates are regulated by the Federal Reserve Board. These regulations limit the types and amounts of transactions (including loans to and credit extensions from the Bank) that may take place and generally require those transactions to be on terms that are at least as favorable to the Bank as prevailing terms for comparable

transactions with non-affiliates. These regulations generally do not apply to transactions between the Bank and its subsidiaries.

Amounts outstanding to/from such affiliates are presented in the table below:

<i>in millions</i>	As of December	
	2011	2010
Assets		
Cash	\$ 409	\$ 61
Securities purchased under agreements to resell, at fair value	4,690	7,827
Receivables from customers and counterparties, brokers, dealers and clearing organizations	1,523	704
Financial instruments owned, at fair value	737	1,341
Other assets	553	864
Total	\$ 7,912	\$10,797
Liabilities		
Deposits due to affiliates	\$ 6,353	\$ –
Other secured financings, at fair value	16	–
Securities sold under agreements to repurchase, at fair value	15,275	9,180
Payables to customers and counterparties, brokers, dealers and clearing organizations	248	284
Financial instruments sold, but not yet purchased, at fair value	570	920
Subordinated borrowings	–	5,000
Other liabilities and accrued expenses (includes \$250 and \$278 at fair value as of December 2011 and December 2010, respectively)	1,009	412
Total	\$23,471	\$15,796

Group Inc. Guarantee Agreement

In November 2008, Group Inc. executed a reorganization of the Bank which involved the transfer of assets and operations to the Bank. In connection with this transfer, Group Inc. entered into a guarantee agreement (see Note 1) with the Bank whereby Group Inc. agreed to (i) purchase from the Bank certain transferred assets or reimburse the Bank for certain losses relating to those assets; (ii) reimburse the Bank for credit-related losses from assets transferred to the Bank; and (iii) protect the Bank or reimburse it for certain losses arising from derivatives and mortgage servicing rights transferred to the Bank. Group Inc. has also agreed to reimburse the Bank for William Street note losses at prices exceeding those at the time of transfer of such notes. In accordance with the Guarantee, as of December 2011 and December 2010, Group Inc. was also

required to pledge approximately \$2.65 billion and \$3.10 billion, respectively, of collateral to the Bank.

The Bank accounts for the Guarantee as a derivative contract under U.S. GAAP. Certain components are accounted for as a receivable from affiliate.

As of December 2011 and December 2010, the Bank recorded \$23 million and \$789 million, respectively, as derivative receivables in “Financial instruments owned, at fair value” with respect to the Guarantee.

As of December 2011 and December 2010, the Bank recorded \$144 million and \$152 million, respectively, in “Other assets” with respect to reimbursement for losses associated with representations and warranties made by the Bank prior to the date of the Bank’s reorganization. See

Notes to Consolidated Financial Statements

Note 18 for further discussion of contingencies associated with such representations and warranties.

For the years ended December 2011 and December 2010, the Bank recorded gains of \$101 million and \$272 million, respectively, in “Gains and losses from financial instruments, net” with respect to the Guarantee. For the year ended December 2011, the Bank recorded an immaterial amount in “Other revenues” related to Guarantee and for the year ended December 2010, the Bank recorded \$152 million in “Other revenues” related to the Guarantee.

Interest Income and Expense

The Bank recognizes interest income and interest expense in connection with various affiliated transactions. These transactions include financial instruments purchased under agreements to resell, financial instruments sold under agreements to repurchase, deposits, other liabilities and accrued expenses, and subordinated borrowings. For the years ended December 2011 and December 2010, the Bank recognized interest income from affiliates of \$68 million and \$112 million, respectively. For the years ended December 2011 and December 2010, the Bank recognized interest expense from affiliates of \$8 million and \$388 million, respectively.

Of the affiliate interest expense recorded for the years ended December 2011 and December 2010, \$21 million and \$194 million, respectively, relates to repurchase agreements with affiliates on which the Bank was prohibited, due to historical regulatory restrictions, from paying interest. As a result, such interest payments were made on the Bank’s behalf by Group Inc. and were recorded as interest expense with a corresponding capital contribution.

Other Transactions

The Bank enters into various activities with affiliated entities and participates in an allocation process related to the revenues generated by particular businesses within those entities. For the year ended December 2011, the Bank received a net reimbursement of \$1.11 billion and for the year ended December 2010, the Bank transferred a net amount of \$3 million. These are recorded in “Gains and losses from financial instruments, net.”

The Bank receives operational and administrative support and management services from affiliates. For the years ended December 2011 and December 2010, the Bank reimbursed U.S. affiliates \$603 million and \$580 million,

respectively, for services rendered which are included in “Management charges.”

The Bank enters into derivative contracts with Group Inc. and its affiliates in the normal course of business. As of December 2011 and 2010, outstanding derivative contracts with Group Inc. and affiliates totaled \$737 million and \$1.34 billion, respectively, in “Financial instruments owned, at fair value,” and \$570 million and \$920 million, respectively, in “Financial instruments sold, but not yet purchased, at fair value.”

During the year ended December 2010, the Bank entered into an agreement designed to mitigate the exposure of Mitsui Sumitomo to potential liquidity requirements resulting from its partnership interest in MMDP. This arrangement required the Bank to enter into total return swaps (“TRS”) with Signum Vanguard Limited (“Signum VIEs”) upon which Signum VIEs issued \$800 million of liquidity notes. Signum VIEs invests the note proceeds via the purchase of liquid assets or eligible reference obligations (“EROs”), the performance of which is referenced by the TRS.

In the event of a default on the part of the Bank or Group Inc., the TRS will terminate and the EROs held by Signum VIEs will be liquidated with the proceeds used to provide Mitsui Sumitomo with access to secured funding. The Bank holds variable interests in Signum VIEs but does not consolidate the Signum VIEs as it has determined it is not the primary beneficiary in accordance with the criteria described in Note 11. Accordingly, the balances related to the Bank’s exposure to the Signum VIEs are included in the nonconsolidated VIE disclosures in Note 11.

Equity Transactions

For the years ended December 2011 and December 2010, the Bank recorded \$146 million and \$201 million, respectively, in non-cash capital contributions.

The contributions recorded for the year ended December 2011 were related primarily to liabilities assumed by Group Inc. on behalf of the Bank in connection with the sale of Litton. The contributions recorded for the year ended December 2010 were related primarily to interest expense paid by Group Inc. on behalf of the Bank to certain Bank affiliates in connection with repurchase agreements.

During the year ended December 2011, the Bank declared and paid a dividend of \$1.00 billion to Group Inc.

Notes to Consolidated Financial Statements

Note 22.

Interest Income and Interest Expense

Interest income is recorded on an accrual basis based on contractual interest rates. The table below presents about the sources of interest income and interest expense.

<i>in millions</i>	Year Ended December	
	2011	2010
Interest income		
Deposits with banks	\$ 76	\$ 57
Securities purchased under agreements to resell, at fair value	41	70
Financial instruments owned, at fair value	546	522
Other interest ¹	134	117
Total interest income	\$ 797	\$ 766
Interest expense		
Deposits	\$ 242	\$ 279
Securities sold under agreements to repurchase, at fair value	48	207
Financial instruments sold, but not yet purchased, at fair value	162	243
Long-term borrowings ²	51	200
Other interest ³	132	214
Total interest expense	\$ 635	\$1,143
Net interest income/(expense)	\$ 162	\$ (377)

1. Primarily includes interest income on loans to customers, collateral, and other interest-earning assets.
2. Consists primarily of interest on subordinated borrowings, other secured financings, and other long-term borrowings from affiliates.
3. Primarily includes interest expense on collateral balances and other interest-bearing liabilities.

Notes to Consolidated Financial Statements**Note 23.****Employee Incentive Plans and Employee Benefit Plans****Stock Incentive Plan**

Group Inc. sponsors a stock incentive plan, The Goldman Sachs Amended and Restated Stock Incentive Plan (SIP), which provides for grants of incentive stock options, nonqualified stock options, stock appreciation rights, dividend equivalent rights, restricted stock, restricted stock units (RSUs), awards with performance conditions and other share-based awards. In the second quarter of 2003, the SIP was approved by Group Inc.'s shareholders, effective for grants after April 1, 2003. The SIP was further amended and restated, effective December 31, 2008.

Restricted Stock Units and Stock Options

Group Inc. issues RSUs to employees of the Bank under the SIP, primarily in connection with year-end compensation. RSUs are valued based on the closing price of the underlying shares on the date of grant after taking into account a liquidity discount for any applicable post-vesting transfer restrictions. Year-end RSUs generally vest and deliver as outlined in the applicable RSU agreements. Employee RSU agreements generally provide that vesting is accelerated in certain circumstances, such as on

retirement, death and extended absence. The subsequent amortization of the cost of these RSUs is allocated to the Bank by Group Inc. Delivery of the underlying shares of common stock is conditioned on the grantees satisfying certain vesting and other requirements outlined in the award agreements. No stock options were granted for the years ended December 2011 and December 2010.

Defined Benefits Plans

Group Inc. maintains a defined benefit pension plan for substantially all U.S. employees hired prior to November 1, 2003. As of November 2004, this plan was closed to new participants and frozen such that existing participants would not accrue any additional benefits. Group Inc. also maintains unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees and their dependents covered under these programs. These plans do not have a material impact on the Bank's consolidated results of operations.

Defined Contribution Plans

The Bank contributes to Group Inc. employer-sponsored defined contribution plans.

Notes to Consolidated Financial Statements

Note 24.

Income Taxes

Provision for Income Taxes

Income taxes are provided for using the asset and liability method under which deferred tax assets and liabilities are recognized for temporary differences between the financial reporting and tax bases of assets and liabilities. The Bank reports interest expense related to income tax matters in “Provision for taxes” and income tax penalties in “Other expenses.”

The Bank’s results of operations are included in the consolidated federal and certain state tax returns of Group Inc. The Bank computes its tax liability as if it was filing a tax return on a modified separate company basis and settles such liability with Group Inc. pursuant to the tax sharing

agreement. To the extent the Bank generates tax benefits from losses, it will be reimbursed by Group Inc. pursuant to the tax sharing agreement at such time as Group Inc. would have been able to utilize such losses. As of December 2011 and December 2010, the Bank recorded a net tax payable of \$842 million and \$431 million, respectively, recorded in “Other assets” and “Other liabilities and accrued expenses.”

The tables below present the components of the provision for taxes and a reconciliation of the U.S. federal statutory income tax rate to the Bank’s effective income tax rate.

<i>in millions</i>	Year Ended December	
	2011	2010
Current taxes		
U.S. federal	\$775	\$ 426
State and local	155	133
Total current tax expense	930	559
Deferred taxes		
U.S. federal	(13)	(92)
State and local	(2)	(17)
Total deferred tax benefit	(15)	(109)
Provision for taxes	\$915	\$ 450

	Year Ended December	
	2011	2010
U.S. federal statutory income tax rate	35.0%	35.0%
State and local taxes, net of U.S. income tax effects	4.4	4.6
Group Inc. guarantee agreement	(1.7)	(9.8)
Contingent liability assumed by Group Inc. in connection with the sale of Litton	1.9	–
Other	1.1	(2.5)
Effective income tax rate	40.7%	27.3%

Notes to Consolidated Financial Statements

Deferred Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities. These temporary differences result in taxable or deductible amounts in future years and are measured using the tax rates and laws that will be in effect when such differences are expected to reverse. Valuation allowances are established to reduce deferred tax assets to the amount that more likely than not will be realized. Tax assets and liabilities are presented as a component of “Other assets” and “Other liabilities and accrued expenses,” respectively.

The Bank has recorded deferred tax assets of \$112 million and \$97 million as of December 2011 and December 2010, respectively.

Unrecognized Tax Benefits

The Bank recognizes tax positions in the financial statements only when it is more likely than not that the position will be sustained on examination by the relevant taxing authority based on the technical merits of the position. A position that meets this standard is measured at the largest amount of benefit that will more likely than not be realized on settlement. A liability is established for differences between positions taken in a tax return and amounts recognized in the financial statements. As of December 2011, the Bank recorded a liability for uncertain tax positions of \$97 million.

The table below presents the changes in the liability for unrecognized tax benefits, which is recorded in “Other liabilities and accrued expenses.”

<i>in millions</i>	As of December	
	2011	2010
Balance, beginning of year	\$ 97	\$ –
Increases based on tax positions related to the current year	54	29
Decreases based on tax positions related to prior years	(2)	68
Balance, end of year	\$149	\$97
Related deferred income tax asset	52	34
Net unrecognized tax benefit ¹	\$ 97	\$63

1. If recognized, the net tax benefit would reduce the Bank’s effective income tax rate.

Regulatory Tax Examinations

All years subsequent to and including 2005 for U.S. Federal, New York State and City, 2004 for New Jersey and 2003 for Utah, remain open to examination by the

taxing authorities. The Bank believes that the liability for unrecognized tax benefits it has established is adequate in relation to the potential for additional assessments.

Notes to Consolidated Financial Statements

Note 25.

Credit Concentrations

Credit concentrations may arise from the Bank's market-making and other activities and may be impacted by changes in economic, industry or political factors. The Bank seeks to mitigate credit risk by actively monitoring exposures and obtaining collateral from counterparties as deemed appropriate.

While the Bank's activities expose it to many different industries and counterparties, the Bank routinely executes a high volume of transactions with asset managers, investment funds, commercial banks, brokers and dealers, clearing houses and exchanges, which results in significant credit concentrations.

In the ordinary course of business, the Bank may also be subject to a concentration of credit risk to a particular counterparty, borrower or issuer, including sovereign issuers, or to a particular clearing house or exchange.

As of December 2011 and December 2010, the Bank held assets of \$1.39 billion and \$3.08 billion, respectively, of U.S. government and federal agency obligations. As of December 2011 and December 2010, the Bank held \$3.85 billion and \$3.33 billion, respectively (4% of total assets at both dates), of non-U.S. government obligations, principally consisting of securities issued by the government of the United Kingdom. The Bank did not have credit exposure to any other counterparty that exceeded 1% of the Bank's total assets. See Note 21 for further discussion of exposures to affiliates.

To reduce credit exposures, the Bank may enter into agreements with counterparties that permit the Bank to offset receivables and payables with such counterparties and/or enable the Bank to obtain collateral on an upfront or contingent basis. Collateral obtained by the Bank related to derivative assets is principally cash and is held by the Bank or a third-party custodian. Collateral obtained by the Bank related to resale agreements is primarily U.S. government and federal agency obligations. See Note 9 for further information about collateralized agreements and financings.

The table below presents U.S. government and federal agency obligations that collateralize resale agreements. Because the Bank's primary credit exposure on such transactions is to the counterparty to the transaction, the firm would be exposed to the collateral issuer only in the event of counterparty default.

<i>in millions</i>	As of December	
	2011	2010
U.S. government and federal agency obligations	\$2,669	\$10,266

Note 26.

Subsequent Events

The Bank evaluated subsequent events through March 29, 2012, the date the consolidated financial statements were issued, and determined that there were no material events or transactions that would require recognition or disclosure in these consolidated financial statements.