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Comments by Lloyd C. Blankfein, Chairman & CEO
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Thanks Mike.

Good morning. To begin with the obvious, our firm and our industry are experiencing a number of changes, with various potential outcomes and consequences.

These changes require us to respond. But, our response should reflect whether we view the change as cyclical or secular. We believe this framework – of trying to identify whether change is more temporary or more permanent – is an important one.

My remarks today will focus on describing those changes, their context, as well as their potential impact, and how we are responding to the near-term and longer term pressures and opportunities.

Markets, by definition, reflect the natural ebb and flow of economic activity, which has meant moving between periods of expansion and contraction. And, that's why it shouldn't be surprising, in a period of contraction and uncertainty, that we would experience lower levels of business activity and risk appetite.

Of course, we respect cycles. Sometimes cycles can last a very long time. They can be so consequential that if you don't react early, you not only forgo the benefits of the cyclical upturn, you risk your ability to recover at all.

Longer term, our early response to today's challenges has given us the wherewithal to more aggressively respond to other, more permanent shifts impacting our industry's future. These secular shifts are being prompted by deep, and in many cases, longstanding structural developments. These include technology, globalization, and, more recently, significant regulatory change.

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No matter the environment, our priority is to generate strong relative returns for our shareholders. And reflecting that priority, we've undertaken a number of initiatives to address cyclical pressures.

We are stewards of an industry-leading franchise that was built over 150 years. We have an equal obligation to meet the demands of the current environment in which we operate, but not completely surrender to it.

For instance, think about the issues that weigh on market sentiment today: The Eurozone crisis, slowing growth in China, and concerns about the approaching fiscal cliff in the United States. While serious, many of these issues are not intractable, can be solved, and will be solved eventually.

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Given these concerns, it is no surprise that corporate activity levels are low. For instance, global M&A volumes are on pace to be down 7% year-on-year in 2012, and, at 5% of global market capitalization, are near historic lows.

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Investor activity has been similarly depressed. For example, New York Stock Exchange volumes are down 24% versus 2010. Activity levels in FICC products have also been challenged. According to New York Federal Reserve data for 2012, agency and corporate bond volumes are down 39% and 15%, respectively, relative to 2010.

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While there has been a reduction in investor activity, the predominant sentiment among corporate managers remains one of caution. Since the end of 2007, business fixed investment as a percentage of GDP has declined from 16% to 13%. We also have seen an increase in cash as a percentage of total assets from 9% at the end of 2007 to 11% as of the third quarter of 2012. While the percentage point difference might not seem that significant, in the context of GDP and total corporate assets, the impact is material.

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We don't see these trends as sustainable unless you believe the sluggish condition of the U.S. and global economy will last forever.

We have taken a disciplined approach to expenses and capital management to ensure that the firm is positioned to benefit when a stronger operating environment returns. However, to generate stronger returns during the upturn, we have to support and invest in our client franchise during the downturn. Getting this balance right translates into outperformance over the cycle.

We announced a $1.2 billion expense initiative with our second quarter 2011 earnings. We have since increased the target by nearly 60% to a run-rate of $1.9 billion in expense savings to be completed by the end of 2012. And, we are on track to meet that goal.

As part of our expense initiative, our headcount is down 8% over the last five quarters. We also have increased the number of people in our high value locations, including Bangalore, Salt Lake City, Dallas and Singapore.

Since 2007, the number of our people in high value locations has nearly doubled, and today represents 22% of the firm's population.

More generally, our industry has a long history of letting go too many people at the bottom of the cycle and over-hiring at the top. Again, our goal is to generate good relative returns during this part of the cycle, but not to jeopardize our future prospects.

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We also have demonstrated a strong commitment to aligning compensation with performance.

As you can see from this slide, we have established a very close relationship between revenue and compensation. We compensate for good years and have restricted pay in weaker years.

For example, in 2011, our revenues were down 26%. Comp and benefits expense was down 21%, with discretionary compensation down significantly more than revenues. From 2007 to 2011, our comp and benefits expense declined by nearly 40% versus peers, while theirs was essentially flat.

Our comp flexibility is also demonstrated through our comp ratio. It has averaged 39% over the past three years -- nearly 6 points lower than our average ratio from 2005-2007 when shareholder returns were significantly higher.

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As part of addressing both near and longer term realities, we also are focused on operating more efficiently under new capital requirements.

Basel 3 will significantly impact the amount of capital attributed to certain businesses. While we are still waiting for greater clarity, we are aggressively managing our risk-adjusted capital levels.

We have a long track record of allocating capital and other scarce resources based on risk-adjusted returns. We allocate funding and liquidity costs to individual businesses to understand the fully-loaded return dynamics. We have provided greater balance sheet and resources to higher return businesses, while downsizing or eliminating lower return businesses.

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We are very focused on activities that are most impacted by the new Basel 3 framework. We have begun to roll out technology that enables us to see capital charges at a very granular level – often security by security.

For example, in our mortgage business, we are able to see the stand-alone capital impact based on individual CUSIPs. We can use the software to run analyses on buying or selling securities in order to understand the capital implications associated with different scenarios.

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Under Basel 3, we currently estimate $728 billion of risk weighted assets. This has declined relative to our previous estimates, based largely on our capital optimization efforts.

In addition to a more active approach to capital optimization in the Institutional Client Services segment, we also plan to reduce the size of our private equity fund investments to comply with Dodd-Frank.

It’s also important to remember that a portion of our Risk Weighted Assets will naturally roll off, such as mortgage securitizations, credit correlation portfolios and certain seed capital investments in our Investment Management Division.

While Basel 3 capital rules are not final and will not be fully phased in until 2019, our best estimate is that at the end of the third quarter, our Basel 3 Tier 1 Common ratio would be approximately 8.5%. We expect that we will ultimately operate with a capital cushion of about 100 basis points versus our regulatory requirement.

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The cyclical pressures are real and we have responded by reducing costs and proactively managing our capital. And, if the environment deteriorates further, we'll take additional action. At the same time, we have maintained our investment and focus on the durable, long-term trends, like regulation, technology, globalization and the BRICs. And, in these areas, we have protected our ability to capture the upside.

While overall headcount is down since 2009, headcount in technology and in the BRICs is up 6% and 64%, respectively.

I'd like to turn to regulation, which has known and unknown effects on the industry. Some of the changes will have a negative effect on our revenue, but in aggregate, they contribute to a safer, more resilient financial system. Of course, the rules need to be implemented effectively so they support strong risk management and dynamic capital markets.

While the ultimate impact of the Volcker rule for the industry remains uncertain, the restrictions on dedicated proprietary trading and the level of investment in future private equity are clear. We believe the implication of these restrictions is lower volatility with a modest impact to average returns through the cycle. Simply stated, the firm's highs should be lower and lows should be higher. Our sales and trading businesses support client activity. So we expect the final rule to acknowledge the criticality of those functions to market stability and client facilitation.

Regulatory reform should promote greater price transparency, automation, and use of central clearing, which we believe will benefit market participants.

And, regulation should bring greater efficiency from standardization. Common standards make it possible to realize operational efficiencies, which means we can grow the volume of our business without significantly increasing costs.

For example, less complex products and standardized documents provide opportunities to automate transactions, reducing processing time and cost while increasing capacity. Central clearing brings together margin functions and reduces the number of entities we communicate with for trade confirmation, collateral management, and reconciliation.

Importantly, greater use of centralized clearing also means equalizing credit terms, which provides more opportunities to compete on intellectual content, responsiveness, execution, and price -- not just solely on the ease of extending credit.

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Looking at the credit profile of our industry both pre- and post-crisis, you'll see significant improvements in capitalization, leverage and risk. Since 2007, Goldman Sachs and our US peers have collectively raised capital that is equal to nearly 60% of 2007 common equity; gross leverage has declined to 11 times from 21 times; and, Level 3 assets have declined by 31%.

Capital has also become more expensive. Risk weighted assets under Basel 3 are 40% higher in aggregate than under Basel I.

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The increase in the cost of capital has been joined by a corresponding rise in the cost of an institution's scale.

For more than a decade, larger size and complexity were viewed entirely as synergistic and virtuous. However, Basel 3 introduces a series of capital surcharges associated with size and complexity that will effectively raise the barriers to entry in some businesses, and force some institutions to be more disciplined about their resource allocation. Although we have significant scale in each of our businesses, many of our investment banking competitors also have sizeable commercial and consumer businesses.

On November 1st, the Financial Stability Board proposed capital surcharges to the world's largest financial institutions. Any synergy from housing multiple businesses together must be weighed against the requirements for more capital and liquidity. For the first time, it's clear that size and complexity come with a higher cost.

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A second secular trend continues to be the role of technology, which is pronounced across three general themes: operational efficiency, client solutions and risk management.

We have always been at the forefront of supporting innovative technology platforms. We were among the founders of Archipelago, ICE, TradeWeb, FXAll, BrokerTec and other important platforms.

We have seen considerable advances over time in clients' use of front-end electronic platforms, which is now leading to the automation of back-end processing as well.

Our ability to transact with our clients over multiple platforms is essential to maintaining our competitive edge. As a result, we have continued to invest in execution platforms across both Equities and Fixed Income.

Within our Equities business, 60-70% of shares are now traded through low-touch channels without the direct involvement of our people. We also are seeing a similar trend in the fixed income markets. In the cash fixed income markets, electronic execution is well developed, representing 70% of the FX Spot forward market and nearly 30% of the rates and credit cash markets. In derivatives, approximately 60% and 10% of the credit liquid index and FX options markets trade electronically, respectively.

To keep pace with the rapid evolution in electronic trading, it is critical that we continue to innovate and create greater operational efficiencies. In fact, the automation of our back office processing has been a natural follow-on to more electronic trading.

One example is the migration of our low-touch equities flow to electronic processing. Of the flow that has moved over, failed trades have declined by 99%. We expect that, over time, all low-touch trades and a significant amount of high touch trades will be processed digitally as well.

Technology also serves an essential function in risk management processes. While judgment remains paramount, the speed, comprehensiveness and accuracy of information can materially enhance or deter risk decision making. We mark to market approximately 6 million positions every day. And, we have sophisticated systems to run complicated stress scenarios across multiple products and regions. In a single day, our systems use roughly 1 million computing hours for risk management calculations.

As a firm, we benefit significantly from having one risk system, improving our efficiency and ability to adapt. Not having to manage and integrate different systems across our businesses will be critical to taking full advantage of the move to standardization, which benefits our clients and the financial system's transparency and resiliency.

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Having a strong global footprint is vital given the secular trend of globalization and the growing influence of the BRICs. Globalization reflects not only the emergence of new, significant markets, but also the evolution and integration of these economies into the global financial system. The BRICs represent new demand for goods and services around the world, and as increasingly important anchors for the global economy, we expect their financial systems to evolve and become more sophisticated.

You can see the impact of globalization by looking at transaction volumes within the BRICs, which represent nearly one-fifth of 2012 Global M&A and IPOs.

In the next five years, we expect further reforms in Chinese capital markets to increase the market's size and our opportunity set.

In more developed markets across Europe, we see an important opportunity for the firm as European debt markets become increasingly active. In leverage finance, for instance, 57% of the issuance since 2010 are bonds -- compared to just 15% pre-crisis.

We expect that higher capital requirements will mean less bank lending and more bond issuance. This will drive higher new issuance volumes and secondary trading activity.

Deleveraging and the re-sizing of businesses in Europe are also likely to lead to market share opportunities over time. In the past two years in Europe, we have grown the number of client relationships by nearly 20%.

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We recognize that, only in hindsight, can we be sure of the effects of both cyclical and secular change. We manage our business in response to the current reality and focus on those factors that we believe are critical to long-term success.

We see three factors that will transcend cyclical or secular trends.

First, financial institutions are deeply reliant on the strength and quality of their client franchises.

Second, a diversified mix of business is essential from a return, risk management and client service perspective. We have a broad set of institutionally-focused businesses that have a track record of providing higher returns than many other businesses within financial services.

Finally, our industry is a people-driven business. Recruiting and retaining world class professionals are vital. Our job acceptance rate has remained consistently around 90% and the firm benefits from long tenures.

Our culture has been a key component of our success and no one takes it for granted. It is a culture of partnership, ownership and collaboration. It is execution-driven, one that believes in not just the power of ideas, but also the necessity of results. It is a culture that has been defined by a willingness to make difficult decisions and continually improve, recognizing the operating environment not for what we hope it will be, but for what it is. It reacts to the present, recognizing the reality of market and regulatory dictates.

Ultimately, it is a performance-based culture, focused on achieving results and growth for our clients, our shareholders, our employees, and the capital markets.

We don’t discount the difficult challenges facing the industry today, and we have responded early and aggressively. But history and our culture have also forced us to think about the risk of going over-board in either direction.

Our financial strength and global client franchise, our proven ability to adapt, and most importantly, the resilience of our people and culture means that Goldman Sachs’ ability to perform is not just intact; it is more compelling than ever.

Thank you and I’m happy to take any questions.