**Testimony of Gregory K. Palm Esq.**
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**Before the Senate Committee on Banking, Housing and Urban Affairs**
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Chairman Dodd, Ranking Member Shelby, and Members of the Committee: My name is Greg Palm and I am the Executive Vice President and General Counsel of The Goldman Sachs Group, Inc. and a member of the firm's management committee.

I appreciate the invitation to appear before you today to provide information with respect to the mortgage market and loan servicing and both our role in the capital markets and our compensation philosophy in the context of the TARP Capital Purchase Program.

Clearly, the last several months have been an extraordinary and unsettling time in financial markets, and the economy generally. The actions taken by the Congress, regulators and the Administration to address the market dislocation have been significant and decisive. We also recognize that much remains to be done and hard and thoughtful work will be required by all of us. We look forward to working with all concerned parties to work our way through the current crisis and to identify and address the failings that have led to this difficult situation.

## About Goldman Sachs

Goldman Sachs is a bank holding company whose principal businesses are investment banking, securities and investment management. We provide a wide range of services to a diverse and significant client base that includes corporations, institutions, governments and high net-worth individuals.

Our activities are divided into three general areas:

Our investment banking business provides strategic corporate services, matching the resources of the firm to specific client needs. This frequently means combining advisory, finance and co-investment capabilities. We help clients tap the equity and debt capital markets, restructure balance sheets, manage assets and liabilities and assess strategic options for M&A, divestitures, corporate defense activities and spin-offs. Through our merchant banking activities, we create and manage investment funds consisting of our own and third party money which invest in a variety of business and levels of the capital structure.

Our sales and trading business facilitates customer transactions for corporations, financial institutions, governments and individuals through market making and trading of fixed income, equities, currencies, commodities and derivatives on such products.

Our asset management and securities services businesses help public and private pension funds, corporations, non-profit organizations and individuals plan, manage and invest their financial assets. We also provide these entities as well as mutual funds and hedge funds with prime brokerage, securities lending and financing services.

***The TARP Capital Purchase Program And Our Role in the Capital Markets***

The Committee asked us to discuss our plans for the use of funds provided under the CPP. As I indicated at the outset, a number of Goldman Sachs' core businesses require the commitment of capital.

In investment banking, offering strategic advice remains at the center of what we do. But clients frequently expect our advice to be accompanied by access to the capital necessary to make that advice actionable and practical. In a variety of circumstances, we not only provide strategic advice but also a significant financing commitment – which may be critical to the feasibility of any plan.

This evolution in our business manifests itself in other ways as well. For example, we often provide back-stop or contingent credit, such as a commitment to make a bridge loan until other sources of more permanent capital can be arranged. In short, our value to clients depends not only on the quality of our advice, but on our willingness to draw on both our expertise and balance sheet to help finance transactions or support a company's strategic direction.

More specifically, in one of our platforms that extends credit through unfunded revolver commitments to clients of the firm, in 2008, we made over $2 billion in new loan commitments and refinanced more than $4.6 billion of previous commitments. Combined, through this avenue, we made underwriting decisions on nearly $7 billion of loan commitments to borrowers. A larger capital base will allow us to continue to provide capital to more of our corporate clients.

Goldman Sachs also plays a very significant role as a market maker. As you all know, market making is essential to the liquidity, efficiency and stability of financial markets. While this function is not new, the extent to which our clients look to us to execute transactions is.

Our securities sales and trading businesses include dozens of distinct areas from equities and fixed income to currencies and commodities—and each of these businesses has many sub-businesses around the world. They allow us to provide our investing and corporate clients with liquidity, capital, market access and knowledge as well as risk management expertise.

Our clients expect us to provide the necessary liquidity, as a market maker, to ensure that buyers and sellers can complete their trades. In doing so, sometimes we either opt, or are forced by market conditions, to hold positions in the near term, while a client's transaction, the underlying reason for the trade, is completed.

In dislocated markets, the role we play as a market maker on behalf of our clients can be challenging. Illiquid markets and the resulting lack of price discovery produce volatility. Having the ability to take the other side of a client's transaction and establish a price for an instrument contributes to the broad functioning of markets.

In recent months, this has been especially true as we have helped our corporate and investing clients manage their exposure to interest rate risk, swings in commodity prices and movements in currencies. The ability to help our clients effectively manage their risk requires capital.

With the $10 billion in capital received through the TARP Capital Purchase Program, Goldman Sachs, through our roles as an advisor, financier and market maker, has additional capacity to inject capital and liquidity, which will contribute to not only the stability of financial markets, but their vitality and growth.

In addition, we play an important role as a co-investor with our clients. Goldman Sachs has and will raise funds to inject capital across the corporate capital structure. These funds will extend needed capital to a variety of companies whose growth opportunities would otherwise be limited.

For example, earlier this year, we recently established a $10.5 billion senior loan fund that makes loans to companies in need of capital. The fund invests both our own capital and that of our clients. This is significant because the normal market mechanisms to facilitate the extension of credit in many areas have broken down. Investors are wary of credit ratings and are reluctant to invest their own money directly. They are looking for some assurance of quality before they are willing to commit capital. Through this fund, each dollar that Goldman Sachs commits is multiplied many times over as we attract capital from our clients. Already, the fund has made several billions in loan commitments to companies.

The strength of our track record and reputation attracts investment funds to us. Our willingness to make tough credit judgments and to commit our own capital has always been a hallmark of our firm.

In the next year, Goldman Sachs expects to launch additional funds and through our global franchise and reputation will deploy additional capital to various parts of the market.

More generally, we are in the business of identifying places where capital can be put to work to generate returns for our shareholders and to increase economic activity. The proceeds from the TARP Capital Purchase Program will be put to work consistent with our mandate to meet the advisory, financing and investing needs of our clients to fund innovation and growth.

**Compensation Philosophy and the TARP Capital Purchase Program**

You have asked us to discuss our compensation philosophy in the context of the executive compensation standards for financial institutions that participate in the TARP Capital Purchase Program ("CPP"), and how we align compensation with performance.

First, a perhaps obvious point – since the year is not yet finished, no financial compensation decisions have been made at Goldman Sachs. We are only now in the process of reviewing performance and making recommendations for year-end compensation for all our employees. In that connection, the Compensation Committee of the Board of Directors, which is comprised solely of independent directors, determines the appropriate compensation for Goldman Sachs' executive officers and that determination is approved by the independent members of our Board of Directors. (For a detailed explanation of the Fiscal 2007 compensation paid to our CEO, CFO and three most highly compensated NEOs, please see our March 7, 2008 shareholder proxy statement.) The Board Compensation Committee also approves the individual compensation of each of our Management Committee members, as well as the several hundred most senior employees of Goldman Sachs who constitute our "partner" group.

Second, we have complied and will comply with all executive compensation standards and restrictions imposed as a result of participation in the CPP. In that connection, the CPP

Executive Compensation requirements will be a focus at our Board Compensation Committee meeting next week.

Third, and most importantly, I want to make clear that the firm's bonuses for 2008 will be paid only out of the firm's earnings for 2008, not its capital. Employee compensation will be dramatically affected by changes in the overall economic and financial environment and our performance for the full year, but it certainly will not increase as a result of receiving TARP funds.

Since we became a public company, we have had a clear and consistent compensation policy. We pay our people based on three factors (1) the performance of the individual; (2) the performance of the business unit; and (3) the performance of the firm as a whole.[1]

We believe this approach has incentivized our people to act in a way that supports the firm as a whole and not be parochial or narrow minded about their specific division or business unit. More broadly, it has produced a strong relationship between compensation and performance, which I will detail shortly.

We do not set aside an actual bonus pool during the course of any fiscal year. Instead, we accrue on our balance sheet a line item for compensation-related expenses for each of the fiscal quarters. Through the first three quarters of fiscal 2008, the amount accrued has been 48% of net revenues for each quarter. This accrual reflects not just potential end of year payments, but also cash compensation paid during the year, expense amortization of prior years' equity-based awards, payroll taxes, healthcare and other benefits, as well as retirement plan and pension fund expenses.

Beginning in the fourth quarter, the firm uses a bottom-up approach to setting year-end compensation. No employee's total compensation is set by formula. As I indicated earlier, bonuses reflect, first, current year individual performance, which is assessed through a robust 360 degree feedback process that includes reference to compliance, teamwork, and corporate citizenship; second, firmwide performance; and, third, divisional operating results.

Compensation for each employee is comprised of salary and bonus. The bonus is paid in cash and/or an equity-based award, depending on the total compensation level of the employee. Generally, the percentage of the discretionary bonus awarded in the form of equity increases significantly as an employee's total compensation increases. In fiscal 2007, for example, the equity portion of our senior most executives compensation was 60%.

All of the equity rewards are subject to future delivery and/or deferred exercise. This aligns employees with the long-term interests of our shareholders. In that connection, I would also note that each of our CEO, CFO, COOs and Vice Chairmen are required to retain at least 75% of the equity they have received (less allowances for the payment of any option exercise price and taxes) as compensation since becoming a senior executive officer.

We believe our compensation policy, which is consistently and rigorously applied no matter how good or bad the market environment, has produced a strong record of aligning performance with compensation.

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[1] *A small number of employees, who are in our Private Wealth Management business, are paid on a commission basis.*

Since 2000, Goldman Sachs has exhibited a correlation between changes in net revenues and compensation of over 98%. Since going public through fiscal 2007, Goldman Sachs has produced a compounded annual growth rate of 21% in earnings per share, 20% in book value per share and 17% in net revenues. Adjusted for increased head count over the period, aggregate compensation expense has increased 10% per year.

All that said, while we are on track to deliver positive results for year-end 2008 despite remarkably challenging markets and events, net revenue for the year will be far lower than in recent years. As such, compensation also will be down very significantly this year across the firm, particularly at the senior levels.

**Mortgage Servicing:**

Goldman Sachs has never been a significant originator of residential mortgage loans. In March 2007, the firm acquired full ownership of a relatively small mortgage originator called Senderra, which had commenced operations in 2006. Since 2007, it has originated approximately 6,300 loans aggregating $1.2 billion. Senderra primarily originates loans that can be purchased by the GSEs and insured by the FHA. Through our principal bank we also have arranged, commencing in August 2007, the origination and purchase of approximately 350 mortgage loans.

A Goldman Sachs affiliate, Litton Loan Servicing, services residential mortgage loans. As of March 2008, Litton ranked 30th in terms of dollar amount of U.S. mortgage loans serviced. The firm acquired Litton a little less than a year ago. Litton services mortgage loans for loan owners, but it does not own the loans. As servicer, Litton has contractual duties to loan owners that it is obligated to fulfill.

As part of its work, Litton expends significant resources to identify homeowners who may be in danger of losing their homes and works with them on potential solutions, like loan modifications, that allow the homeowners to stay in their homes. Over time Litton has been able to demonstrate to loan owners that loan modifications very often produce lower losses than foreclosures.

Litton has a long track record in modifying loans. Even before the current crisis, Litton began to streamline its programs for modifying at-risk loans. This approach, for example, has allowed Litton in the last twelve months to modify in excess of 41,000 mortgage loans totaling approximately $7.5 billion in principal balance. This amount represents approximately 12% of Litton's total loan portfolio and more than 38% of its 60-plus days delinquent portfolio over the past 12 months. This is approximately a 400% increase in modifications over the previous year.

With these modifications, Litton has written down approximately $246 million in debt and waived approximately $17 million in fees for homeowners, resulting in an average monthly payment reduction of 10%-15%. These modifications changed the terms of the original loan and in most cases included one or more of the following: waiver of all or part of arrearages, forgiveness of fees and charges, principal reductions, decreases in interest rates and/or term extensions.

Litton has recently commenced efforts to inform our customers about the new Hope for Homeowners program. As a servicer of mortgages, Litton cannot offer homeowners a Hope for Homeowners loan, but it is actively building relationships with mortgage originators who can. As part of an on-going, collaborative dialogue, Litton, as well as other mortgage servicers, have agreed with Maryland, Minnesota and Ohio to take certain measures designed to avoid foreclosure and preserve homeownership . Litton has also established constructive relationships with housing counselors and local community groups to connect with homeowners to offer mortgage solutions.

Many homeowners are currently facing significant economic headwinds in the form of higher unemployment, wage compression, high debt load and other issues. Litton recognizes this and is committed to doing all that it can to identify "solutions" that both fulfill its duties to loan owners and help homeowners stay in their homes wherever possible.

Although modifications to existing mortgage terms are not a magic panacea that will cure all that ails the current housing market, we believe that thoughtful restructuring of existing arrangements to provide homeowners with payment relief is a positive step toward combating its decline.

***Conclusion:***

Mr. Chairman, we look forward to working with you and the Committee to accomplish the important tasks set out in the Emergency Economic Stabilization Act. Vibrant, liquid, capital markets are an important part of a strong economy, and are a necessary component to the stabilization of communities and greater economic opportunities for all. Thank you.