Testimony from Craig W. Broderick
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Chairman Angelides, Vice Chairman Thomas and Members of the Commission:

Good afternoon. My name is Craig Broderick. I have been the Chief Risk Officer of Goldman Sachs since 2007, and prior to that, the firm's Chief Credit Officer. I am responsible for credit, market and operational risk, and insurance. I would like to start by addressing the role of risk management within Goldman Sachs.

Our firm assumes risk as an integral part of its business of making markets, underwriting, and otherwise providing a wide range of financial services to our clients. The nature of our role as a financial intermediary means that we take this risk willingly, but only subject to basic principles which define our overall approach to prudent risk management.

First, we must understand the risk that we are taking – how we measure it, how much we are taking, in what form, with whom, for how long, under what circumstances, and by how much the risk might increase as market conditions change. Second, we must determine how we can control the risk – that is, how we can mitigate it through hedging and other means, how we can ensure it does not become too concentrated, or that it does not have the potential to cause problems in adjacent areas. Third, we must feel comfortable that we can achieve a return for our shareholders that is appropriately aligned with the level of risk we are taking. In every instance, we seek to take risk only within carefully calibrated limits, and scaled to be in line with our own financial resources.

To ensure disciplined risk management across our businesses, we have built a substantial risk organization across Goldman Sachs. What's more, an ethos of risk management permeates the entire firm, as core to our overall corporate culture and borne out in our everyday practices.

Specifically, our risk management framework is built around four core components.

The first is effective *governance*, of which independence is the cornerstone. The entire control side of the firm – comprising roughly 50 percent of Goldman Sachs, including risk officers, controllers, operations, technology, treasury, legal and compliance, and others – does not report to, and has complete independence from, their counterparts in the revenue generating divisions. For example, while our business units routinely provide useful viewpoints as to the appropriate credit or other limits for a given counterparty or trade, it is the independent risk management professionals who ultimately set the parameters. Similarly, if there is ever a question about a mark, it is our Controllers group that has the final say. Effective governance also comes from extensive participation by all levels of the firm, through the use of formal committees, informal postings, and rapid escalation of risk-related matters.

The second component is *information*. We firmly believe that you cannot manage what you cannot measure, and in fact extend this to say that you cannot manage well what you do not measure accurately. As such, a central tenet is our daily discipline of marking all of the firm's positions to current market levels. Such prices reflect not where we think they should be, or where we wish they were, or where we think they will be tomorrow, but rather, where we can trade them today. We do so because we believe it is one of the most effective tools for assessing and managing risk, providing the most transparent and realistic insight into our risk positions and associated exposures.

Good information also requires having risk systems that capture our positions on a comprehensive and timely basis. We have invested heavily in our risk technology over many years, and today have systems that, while certainly not perfect, are able to track and analyze our positions in a wide range of ways that provide valuable insights as we evaluate our portfolios.

The third component is *people*. Even the best technology serves only as a tool for helping to make informed decisions in real time about the risks we are taking. Ultimately, effective risk management involves people making continual portfolio interpretations and adjustments. Our credit and market risk limits are monitored on a daily basis, and informed by a constant dialogue between our traders and risk managers. During especially abnormal market conditions, it is the experience of our business and risk management professionals, and their appreciation for the nuances and limitations of each risk measure, that helps guide the firm in assessing its exposures and maintaining its risk exposures within prudent levels.

Finally, the fourth component of our risk management structure is *the active management of our positions*. As a component of this, we believe that proactive hedging of our market and credit risks is beneficial both to our clients and our firm, most notably by minimizing the potential need for us to take outsized actions during periods of stress. More broadly, effective risk management, including hedging, also serves to reduce system-wide risk, minimizing the likelihood that a counterparty failure of any size could adversely affect the system.

In hedging our market and credit risks, we make active use of a variety of derivatives, which I know is of particular interest to the Committee. We do so not because they are the singular means for hedging, but because they are often the most efficient. Credit derivatives, for example, often are useful in helping us to facilitate the extension of credit to a client, and may make the difference as to whether a transaction can be executed for that client.

Finally, given much focus on the role of derivatives as a contributor to the financial crisis, my view is that this crisis occurred primarily as a result of widespread inadequate risk management and, at its heart, by poor lending decisions – where low interest rates, a search for yield and other factors lead to a deterioration in lending standards. The effects of these poor lending decisions were multiplied through the use of securitization and other off balance sheet vehicles, which reduced not only capital available to cover losses but also the transparency of the risks. Certainly, derivatives facilitated further leverage in the system, but from the data that I have seen, they were relatively small contributors, as the overall losses in this space were a fraction of the cash lending-related figures. Of course, that is not to minimize their potential impact on a single institution or the system's stability if not managed appropriately.

That is why we approach the use of derivatives and counterparty interactions in the same way we manage other types of risks: by applying disciplined fair value accounting, performing multiple types of risk analyses and measures, requiring strict collateral arrangements, and managing individual by individual counterparty exposures so that, in aggregate, the firm's overall level of risk is kept at prudent levels. Notably, we approached our interactions with AIG by exercising the very same principles and conservative risk management practices.

To be sure, we have all learned valuable lessons from market events in recent times, and it is clear that no approach to risk management was without its limitations. However, we believe that the four basic principles that comprise our risk management framework – governance rooted in independence, good information, experienced risk professionals, and proactively managing our positions – were largely effective in the face of unprecedented market turmoil.

Thank you and I look forward to answering your questions today.